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OVERFUNDING AND UNDERFUNDING OF PENSION PLANS

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

AND THE

SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

OF THE

COMMITTEE ON
EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

EXAMINING THE OVERFUNDING AND UNDERFUNDING OF PENSION PLANS

MARCH 24, 1987

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OVERFUNDING AND UNDERFUNDING OF PENSION PLANS

TUESDAY, MARCH 24, 1987

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
AND
U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS,
COMMITTEE ON EDUCATION AND LABOR,
Washington, DC.

The joint hearing convened, pursuant to notice, at 9:00 o'clock a.m., in room SD-430, Dirksen Senate Office Building, co-chaired by Senator Howard M. Metzenbaum, chairman, Senate Subcommittee on Labor, and Representative William Clay, chairman, House Subcommittee on Labor-Management Relations.

Present: Senators Metzenbaum, Quayle and Harkin; Representatives Clay, Roukema, Roybal, Sawyer, Hayes, Murphy, Owens, Petri and Jontz.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. This hearing will come to order.

It is a rather unusual hearing in that it is a joint hearing with Senate and House committees. I am very happy to work with Congressman Clay, Congressman Roybal, and Congresswoman Roukema.

Today's hearing will focus on the failure of current law to protect the retirement security of the 38 million participants in defined benefit pension plans. We will hear from retirees whose pensions were terminated because their companies failed to fully fund them, or because they were used for corporate ventures.

These workers and millions of others believed the pension promises made by their employers. They had no idea that their pensions were not secure. They assumed there were laws to protect them. Sadly, they were wrong.

Companies have turned their pension plans into corporate piggy banks. Since 1980, nearly $12 billion—$12 billion—has been removed from so-called overfunded pension plans. And in the process workers have lost retirement security.

While the corporations grabbed the money from the funds, it was the workers who suffered.

An internal Labor Department report concluded that participants lose as much as 45 cents of every pension dollar promised.

And after 6 years of ignoring this very serious problem, the Administration in its pension reform proposal at last recognizes that such a termination, quote, "reduces participants'-benefit security."

In addition, despite a law that requires pension assets to be managed exclusively for the benefit of participants, pension plans are being manipulated to help finance corporate mergers and acquisitions.

For example, corporate raiders such as David Murdock have used pension funds of companies they control to buy stock of takeover targets. Even when such purchases result in substantial premiums, the retirees never get to share in the windfall. Instead their pensions are pulled out from under them and terminated.

There is case after case after case of raiders coming in, of corporate takeovers occurring, and after the corporate takeover occurs, the pension plan is terminated.

Stock control by pension plans should be voted in the best interest of plan participants, not used to protect management. But that is not always the case. GTE and Rockwell have requested chief executive officers of other Fortune 500 companies to lobby their pension managers to vote stock in favor of anti-takeover measures.

Understand what I am saying. They are telling the managers of pension funds how to vote their stock with respect to anti-takeover measures. That is not the responsibility of the pension managers. That violates their trust. In fact, I question the legality and the propriety of what those trustees are doing.

But if that were not bad enough, to have the trustees' integrity being placed in question, we now find that one of the most prominent anti-takeover lawyers in the country has sent out a letter, urging his clients to follow the lead of GTE and Rockwell.

I have respect for Mr. Marty Lipton, but when Marty Lipton sends a letter out to his clients telling them—urging them—to follow the lead of GTE and Rockwell and instruct the pension managers how to vote with respect to the funds of the pension and how they are used, and in connection with issues having to do with anti-takeovers, I question the propriety of a lawyer doing that.

I believe a trustee has a responsibility only to the beneficiaries of that trust, and when that trustee is told how to vote or specifically told by a lawyer how to vote or by the corporate executive how to vote, they are violating that trust. And how a lawyer can send such a letter out, urging clients to participate in this endeavor is very questionable to me.

Wall Street investment bankers are also now laying claim to pension assets. In the case of Schick's acquisition of Reeves, the financing terms included a provision that Reeves' pension plan be terminated as a condition of the loan, with the so-called surplus going back to the banks. This forced termination holds a pension plan hostage to a corporate reorganization. It is a practice that should not be tolerated.

While some companies have removed $12 billion from healthy pension plans, other companies fail to fully fund their pension promises. Retirees who have lost their pension benefits as a consequence feel betrayed by a system that should be protecting them.

The situation cries out for reform. No situation demonstrates this fact more than the termination of LTV's pensions which were

$2.5 billion in the red. Workers lost early retirement supplements and plant shutdown payments. Now these very same retirees are struggling to survive.

One salaried plan was amended to increase the value of lump sum payments by 20 percent. These lucrative payments drained the plan of $272 million, leaving only $7,700 in the plan when it was terminated.

Four participants in the very decision to increase the value of the payments themselves walked away with prizes ranging from $451,000 to $1.2 million. How the chief executive of that company had the audacity to participate in that kind of a change in a plan increasing his benefits by 20 percent, taking out $1.2 million, and then leaving his pensioners to fend for themselves to me is just incredible. And frankly, I am not proud of the fact that he came from my own community.

The plan is now operated by the Pension Benefit Guarantee Corporation. Those who remain in it will receive substantially reduced payments. For them, the system has failed. We must make sure that pension plans do not become hollow promises. We need to protect them from takeover artists and self-serving managers, and we need to restore confidence in our pension system. I hope that today's hearing will permit us to determine where consensus exists, and will enable us to move forward on a bipartisan basis to enact appropriate legislation.

OPENING STATEMENT OF SENATOR QUAYLE

Senator **Quayle**. Mr. Chairman, I am glad to be here this morning to receive testimony regarding over and underfunded pension plans. For many decades the United States has had a commitment to economic security in retirement. The Nation has attempted to meet this commitment by encouraging private employer-sponsored pension plans and individual savings, and by establishment of the Social Security Program.

The growth of the private pension system, limited employment opportunities for the aged, the failure to save for old age and a changed concept of filial responsibility have all contributed to increasing expectations of private pension and welfare benefit programs and Social Security. As public and private sector pension programs have matured and as participant and beneficiary populations have grown, the costs have grown also. The costs have grown so much, that the Social Security System now dominates the Federal budget and private employer-sponsored pension plans are of major importance to Federal policy and the capital markets.

Recent abuses of the private pension system, and the $4 billion deficit of the Pension Benefit Guaranty Corporation, compel us to revisit many issues which have been discussed before, among them, minimum funding standards, aggregate liability, funding waivers, reversions and, most of all treatment of underfunded pension funds.

While I have questions about some of its provisions, I am impressed by the administration's proposal to address these serious problems. I recognize that the proposal is in any early stage. Many of my concerns may be addressed by detail and transition rules of the actual legislation.

I feel very strongly that strengthening minimum plan funding standards will further the goal of limiting the PBGC's exposure to future losses—but more must be done in this area. And, I am happy to see that there are proposed changes to rules regarding minimum funding waivers and a variable rate premium.

This proposal addresses many of the abuses of the current pension system. I look forward to working with the administration, my colleagues and interest groups to achieve a consensus bill.

Senator METZENBAUM. Congressman Clay?

Mr. CLAY. Thank you, Mr. Chairman.

I ask unanimous consent to insert a full statement in the record, and at this point, I will summarize.

Senator METZENBAUM. Without objection.

OPENING STATEMENT OF CONGRESSMAN CLAY

Mr. CLAY. Terminations of overfunded and underfunded pension plans are serious threats to workers' and retirees' benefit security.

No worker should experience the pain associated with the termination of an underfunded pension plan. If you close your eyes and listen to the stories of the LTV retirees, you may think that we were back in 1973 before ERISA, listening to the Studebaker retirees speak with such emotion about the loss of their plans and their pain.

But this is 1987, and at least one thing has changed. The Pension Benefit Guaranty Corporation exists, and every LTV retiree has the assurance that a minimum level of benefits will be paid.

But why should these retirees and workers suffer any loss of benefits at all? We should change the law to guarantee that future retirees will receive their full promised and earned benefits.

Another serious threat to benefit security exists when employers prematurely terminate pension plans that are overfunded. Since 1980 we have seen an explosion of plan terminations, engineered by employers wanting access to so-called surplus assets. Participants suffer real, long-term benefit losses when plans terminate prematurely, even though they may receive the nominal benefits they have earned as of the termination date.

Overfunded pension plans have become pawns in corporate takeover wars as our witnesses from Reeves Brothers will tell us today.

We must reaffirm the fundamental premise that pension plans are established and given tax-favored treatment to provide retirement benefits. We must make sure that any assets employers might be allowed to recover are truly surplus.

This morning we will focus on the administration's proposals to amend ERISA to deal with these problems. The proposals affect three different areas of current law as they apply to single-employer pension plans: first, terminations of overfunded and underfunded pension plans; second, the minimum funding standards, and third, the use of surplus assets to pay health benefits to current retirees.

We are pleased to see that the administration apparently agrees, on the importance of this issue since the Secretary of Labor is here as our lead-off witness.

Mr. Secretary, I want to take this opportunity to welcome you and to commend you for your leadership in developing this legislative package. It is a comprehensive approach to some very serious problems. I especially want to commend you for doing something that many said could never be done—getting all of the ERISA agencies working together toward the same goal.

I hope, now that your proposals have been sent up here to the Hill, that we here can follow your example and work with our colleagues on the tax committees to fashion a legislative proposal as quickly as possible.

I commend you, and I welcome you to the hearings.

Senator **Metzenbaum**. Thank you, Congressman Clay.

[The prepared statement of Congressman Clay follows:]

Statement of

William L. Clay
Chairman
Subcommittee on Labor-Management Relations
House Committee on Education and Labor

March 24, 1987

This morning we are examining two serious threats to worker and retiree benefit security that have occurred all too often in the recent past: terminations of overfunded and underfunded pension plans.

No one can articulate the loss and the pain associated with the termination of an underfunded pension plan as well as the LTV retirees you will hear today. Their promised and earned pension benefits have been slashed and their health benefits are only continuing because Congress stepped in last year and passed a law to prevent those benefits from being terminated before May 15, 1987. If you close your eyes and listen to the testimony, you may think we're back in 1973 -- before ERISA -- listening to the Studebaker retirees speak with such emotion about their loss and their pain.

But this is 1987 and at least one thing has changed: the Pension Benefit Guaranty Corporation exists and every LTV retiree has the assurance that a minimum level of benefits will be paid. Yet you might ask -- as we will today -- why should these retirees and workers suffer any loss of benefits at all and how can we change the law to improve the chances that future retirees will receive their full promised and earned benefits.

Another serious threat to benefit security exists when employers prematurely terminate pension plans that are overfunded on a termination basis. Since 1980 we have seen an explosion of plan terminations engineered by employers wanting access to so-called surplus assets. Participants suffer real long-term benefit loss when plans terminate prematurely, even though they may receive the nominal benefits they have earned as of the termination date. Overfunded pension plans have become pawns in corporate takeover wars as our witness from Reeves Brothers will tell us today. It is time that Congress acts to reaffirm the fundamental premise that pension plans are established and given tax-favored treatment to provide retirement benefits. They are not corporate piggy banks. We must make sure that any assets employers might be allowed to recover are truly surplus.

This morning we will focus on the Administration's proposals to amend ERISA to deal with these problems. The proposals affect three different areas of current law as they apply to single-employer pension plans: first, terminations of overfunded and underfunded pension plans, second, the minimum funding standards, and third, the use of surplus assets to pay health benefits to current retirees.

As you know, our hearing today is a joint House-Senate hearing. To my knowledge, this is the first time we have held this type of a joint hearing on pension issues. One of the reasons that Senator Metzenbaum and I are having this hearing is to send the word to all of you that we consider these issues to be of utmost importance and urgency.

We are pleased to see that the Administration apparently agrees, since the Secretary of Labor is here as our leadoff witness.

Mr. Secretary, I want to take this opportunity to welcome you and to commend you for your leadership in developing this legislative package. It is a comprehensive approach to two very serious problems: the premature termination of defined benefit plans to allow employers to recapture so-called surplus pension assets and certain problems with the current minimum funding standards that may put participants and the Pension Benefit Guaranty Corporation at greater risk than is desirable. Although there are features of your proposal that trouble me greatly and certain glaring omissions, such as its failure to provide additional benefits to plan participants and retirees on plan termination, your proposal is a positive step forward.

I especially want to commend you for doing something that many said could never be done: getting all the ERISA agencies working together toward the same goal. I hope now that your proposal has been sent up here, we can follow your example and work with our colleagues on the tax committees to fashion a legislative proposal as quickly as possible that we can all support.

I look forward to working with you and welcome your testimony today.

Senator METZENBAUM. Congresswoman Roukema?

OPENING STATEMENT OF CONGRESSWOMAN ROUKEMA

Mrs. ROUKEMA. Thank you, Mr. Chairman and Congressman Clay.

I will have only brief remarks. I am most anxious to hear from the Secretary. I want to personally thank the Secretary for being here, express my appreciation for the fact that he has taken the initiative within the administration to fashion a comprehensive proposal and be here not only in a courageous position, but also an intellectually honest position, in my opinion, in addressing these contentious issues.

The goals of the proposal are laudable. We need to increase the retirement income security for American workers who participate in defined benefit plans by ensuring better funding and discouraging plan terminations. That is our goal.

However, the issues are contentious, they are complex, and the testimony we hear today will probably only tend to underscore the complexity of the problem.

However, I would suggest that as you presented your proposal, Mr. Secretary, it seems to pass the test of reasonableness. We shall find today how reasonable we can all be on these subjects.

But I would like to underscore what my Chairman, Mr. Clay, has said, and the Chairman of the Senate committee as well. They have both alluded to the fact that we seek consensus.

The history of ERISA legislation includes an important tradition, I believe begun by my former colleague, who is in the audience with us today, Congressman Erlenborn, that we seek nonpartisan approaches to protecting the private pension plans of this country.

So I again pledge myself to a nonpartisan consensus approach to these complex and contentious issues, and I thank you, Mr. Secretary for being with us.

Senator METZENBAUM. Thank you, Congresswoman Roukema. We look forward to working with you.

Congressman Roybal, whose voice has certainly been heard on this issue over a period of many years, we are very happy that you are with us this morning.

OPENING STATEMENT OF CONGRESSMAN ROYBAL

Mr. ROYBAL. Thank you, Mr. Chairman.

Mr. Chairman, I would like to commend you and Congressman Clay for convening this most important hearing and to express the hope that it will serve to spur this Congress to enact legislation to eliminate overfunded terminations as we have known them.

In all too many cases, the pension benefit rights and interests of American workers, their beneficiaries and retirees have been adversely affected by these overfunded terminations.

I believe that the Congress has an obligation to protect the legitimate benefit rights and expectations of workers and retirees. This should be the true measure of any proposal which is considered to resolve this continuing dilemma.

I will shortly introduce legislation to make all defined benefit pension plans irrevocable. Simply, once contributions have been made to the plan, under no instance could these funds ever revert back to the employer. These funds should be exclusively committed to provide benefits to workers and retirees covered by these plans.

This is a simple solution, but I believe it is an effective one.

While I am encouraged by some aspects of the administration's overfunding and underfunding proposal, I am particularly troubled by the concept of withdrawal of surplus assets. These amounts, I believe, represent the deferred wages of workers and retirees. Withdrawal can simply mean another word for taking someone else's money.

Just as this administration has adopted the drug slogan, "Just Say No", I believe it is time for the Congress to call a halt to the continuing rash of employer-sponsored overfunded plan terminations, takeovers, green mail, leveraged buyouts, and other gimmicks, which erode the retirement benefit security of the American worker and retiree. It is time for the Congress to "just say no" to overfunded pension plan terminations.

Senator METZENBAUM. Thank you, Congressman Roybal.

[The prepared statement of Congressman Roybal follows:]

SELECT COMMITTEE ON AGING
U.S. HOUSE OF REPRESENTATIVES
EDWARD R. ROYBAL, CHAIRMAN

MARCH 24, 1987

STATEMENT OF EDWARD R. ROYBAL CHAIRMAN OF THE HOUSE SELECT COMMITTEE ON AGING BEFORE A JOINT HEARING OF THE SENATE LABOR SUBCOMMITTEE AND THE HOUSE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS ON "OVERFUNDED AND UNDERFUNDED PENSION PLANS"

Thank you Chairman Metzenbaum and Chairman Clay for this opportunity to participate in your hearing concerning "Overfunded and Underfunded" defined benefit pension plans. I want to commend both of you for convening this most important hearing and express the fervent hope that it will serve to spur this Congress to expeditious enactment of legislation to eliminate overfunded terminations as we have known them. In all too many cases, the pension benefit rights and interests of American workers, their beneficiaries and retirees have been adversely affected by these overfunded terminations.

The Administration has put forward a proposal to allow "withdrawal" of surplus assets as a remedy to overfunded terminations. However, I believe it is imperative for the Congress to enunciate a standard by which any initiative or proposal in this area should be measured. That standard should be that the promises made by an employer to provide a defined benefit in the future to his employees must be observed and supported by federal policy and law. This would simply mean that contributions and earnings to a pension plan should be "irrevocably" committed to provide those promised benefits to participants and retirees. In other words, an employer should not profit or obtain a tax preference in the form of a reversion by terminating an overfunded pension plan. Moreover, this same proposition should be observed to the fullest extent possible with respect to employers with underfunded plans that do not meet the benefit promises which they have made to their employees.

While the Administration proposal advances withdrawal of excess assets from an overfunded plan as the principle mechanism to deter overfunded terminations, I believe that we in the Congress must seriously pause before we so fundamentally change our defined benefit system to provide this "easy access" checking account approach to the funding of our defined benefit plans. Such an approach, in the final analysis, only along with significant safeguards to insure benefit security for participants and retirees, may be necessary. However, before we reach that stage I would like to advance a simpler approach, one which I believe is consistent with the thrust of ERISA and revitalizes the meaning of "exclusive benefit" to which ERISA speaks.

I will shortly introduce legislation to make all defined benefit pension plans "irrevocable." Simply, once contributions have been made to the plan, under no instance could those funds ever revert to the employer. Rather, these funds would be exclusively committed to provide benefits to workers and retirees covered by these plans. This is a simple solution, but I believe an effective one.

A principle criticism that will be advanced against this and any other proposal to limit asset reversions is that employers will "minimally" fund their plans. I have two responses to this criticism: 1.) Historically, there have only been a minority of employers who have sought to minimally fund their plans. This was true prior to the recent trend of terminations, as it is today. I believe a prohibition on reversions will not inevitably lead to less secure funding. It is simply not in the interest of employers to make their pension benefit commitments less financially secure through minimally meeting their funding obligation. 2.) The second reason that employers will not reduce their funding to plans, if restrictions are placed on reversions, is that we in the Congress can and should mandate stricter funding standards to prevent such minimal funding. This essential approach is embodied in the second part of the Administration's proposal concerning underfunding.

In closing, I would like to note that I am encouraged by some aspects of the Administration's proposal. However, I believe the Congress has an obligation to protect the legitimate benefit rights and expectations of workers and retirees. This should be the true measure of any proposal which is considered to resolve the continuing dilemma of underfunding and overfunding.

Providing even greater access through withdrawal to plan sponsors should only be considered as a last resort and only if significant protections for workers and retirees are assured. Withdrawal is simply another word for taking someone else's money. That has been tolerated, indeed facilitated, by the policies of this Administration. Just as this Administration has adopted the drug slogan "just say no," I believe it is time for the Congress to call a halt to the continuing rash of employer-sponsored overfunded terminations, takeovers, green mail, leveraged buy-outs and other gimmicks which erode the retirement benefit security of the American worker. It is time for the Congress to "just say no" to overfunded pension plan terminations.

Senator **Metzenbaum**. Congressman Sawyer, we are particularly pleased to have you join us here this morning. You are from my own State, from Akron, OH, former Mayor. We are pleased that you have seen fit to join us and will be happy to hear from you.

Mr. **Sawyer**. Thank you, Mr. Chairman. I thank both you and Chairman Clay for the opportunity to join you this morning.

I do not have a prepared statement. Let me simply summarize by saying that as a representative of a community that in the last 3 months has faced the potential of three and perhaps four major takeovers that we are particularly sensitive to the potential dangers of that kind of "speculative investment"—is that a polite way to put it?

Senator **Metzenbaum**. Very polite.

Mr. **Sawyer**. The aspect of that particular kind of undertaking that we are reviewing this morning is of particular concern; the kind of experience that LTV, and the community just north of my own, has been through is not something that we want to replicate anywhere else in Ohio. So I am particularly grateful for your concern over this particular issue and thank you for the chance to join you this morning.

Senator **Metzenbaum**. Thank you very much, Congressman Sawyer.

Congressman Hayes, we are happy to welcome you this morning. Do you have an opening statement, sir?

Mr. **Hayes**. Thank you very much, but the price you pay, Senator, for being late is to keep your mouth closed. [Laughter.]

Senator **Metzenbaum**. Thank you very much.

We are very pleased that our first panel consists of the Secretary of Labor, Bill Brock, and Kathy Utgoff, Director of the Pension Benefit Guaranty Corporation; Dennis Kass, Assistant Secretary of Labor; and Roger Mentz, Assistant Secretary of the Treasury.

Secretary Brock, we are happy to welcome you again and look forward to working with you in connection with this matter.

STATEMENTS OF HON. WILLIAM E. BROCK, SECRETARY, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY DR. KATHY UTGOFF, DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION; DENNIS KASS, ASSISTANT SECRETARY OF LABOR, AND ROGER MENTZ, ASSISTANT SECRETARY OF THE TREASURY

Secretary **Brock**. Thank you, Mr. Chairman.

I should begin by thanking you and Congressman Clay for convening the joint hearing. That is unusual, and I think it demonstrates not only your concern with the issue, but the importance of the subject matter we are discussing.

This is legislation that will affect more Americans than virtually any piece of legislation that Congress has passed since the ERISA bill was first enacted in the 1970s, so it is of consequence, and it is fundamentally important to pick up from Mrs. Roukema's comments that we approach it in a nonpartisan and a thoughtful fashion to see what we can construct to deal with some problems that we have clearly identified.

You mentioned the three people who are here with me—Kathy Utgoff, Dennis Kass and Roger Mentz. These are the three individuals who are most responsible for thinking this matter out over the last year and a half since I guess you and I had our first conversation, Mr. Chairman, back in 1985 when I was talking to you about seeking this responsibility as Secretary of Labor. We have been working for almost 2 years now to try to be very sure that what we do in this area is constructive and positive.

I will summarize my testimony and submit it for the record, but it is excellent testimony, and I commend it to you, so be sure and read it.

Senator METZENBAUM. We will be very pleased to receive it, and the entire statement will be included in the record.

Secretary BROCK. It is really good.

Senator METZENBAUM. There is a lot of demand for the rights to publish it as a novel. [Laughter.]

Secretary BROCK. That may come after we have the hearings.

Mr. KASS. It is nonfiction, Senator.

Secretary BROCK. We have, without any qualification, the world's finest pension system. We have strengthened it enormously by the actions of those who have come before us, primarily people like John Ehrlenborn, Jack Javits—who wrote this legislation in the 1970s. I was privileged to serve with Senator Javits at that time and think that this may be his greatest contribution among many really wonderful contributions that he made to this country.

We, I think, all of us, believed in those days that the pension promise was reasonably well-secured through the enactment of the Employment Retirement Income Security Act of 1974, or ERISA. But there are two disturbing trends which demonstrate, I think, major weaknesses in the current law that we did not adequately address at that time.

The first relates to the termination of overfunded pension plans and the recovery of excess assets. The second relates to the termination of severely underfunded pension plans.

Until recently, terminations of overfunded plans was a relatively unusual event. In 1980, we had only nine plans, and they involved about $20 million. In 1985, activity peaked with 525 plans, as you and I discussed in 1985, and over $6 billion in assets reverted to the employers.

Most of the employers who have terminated a plan have not abandoned their defined benefit plans. Rather, they have reestablished very similar or identical plans. Clearly, the purpose of the termination was to recapture the unanticipated assets that have accumulated.

I think it has become fairly obvious that requiring employers to terminate their pension plans in order to recover assets well in excess of those needed to maintain proper funding is inconsistent with a stable and secure pension system.

There is concern that the reestablished plans having been stripped of all their assets in excess of termination liabilities might not have sufficient assets to maintain sound funding during an economic downturn.

Furthermore, without a cushion of assets, plan sponsors will be less likely to increase benefits or grant cost-of-living increases to employees.

The second disturbing effect is the recent increase in seriously underfunded defined benefit plans due to inadequacies of the current minimum funding standards. The Department estimates the total underfunded liability of underfunded plans is about $45 billion. We believe that up to half of this amount is in 25 to 35 large underfunded plans.

Recent terminations of some of these significantly underfunded plans have resulted in massive and growing liabilities for the PBGC, the corporation the Government set up to guarantee pension benefits in these defined plans.

Because neither the PBGC nor the employer is responsible for all unfunded benefits when a plan terminates, these terminations have deprived many employees of the full benefits they had earned as of the date the plan terminated. For many of the large underfunded plans still in existence, it may be too late for this proposal to help.

But we are suggesting that we can prevent these large unfunded liabilities from recurring in the future, and that has to be our primary task.

Many of the losses are due to weaknesses in the current funding provision of ERISA. In some cases, underfunded plan terminations have involved plans whose sponsors have at all times complied with the minimum funding standards of ERISA. Now, this is important because in fact, a lot of these plans have never even received a waiver from the IRS and still had almost no money in their plans when they were terminated.

It seems incredible to me that a plan could comply fully with ERISA with its minimum funding standards and yet terminate in insolvency.

What we are asking is a cooperative effort, Mr. Chairman, with you to solve these issues. We do believe that employers should always be allowed to terminate a plan when they no longer wish to offer a defined benefit plan to their employees, in contrast to the suggestion of Mr. Roybal.

Current law forces an employer to terminate a plan in order to recover excess assets. We do not think that makes sense, either. It often results in a plan being immediately reestablished with less assets than is appropriate.

Our proposal would permit an employer to withdraw assets from an ongoing defined benefit plan, provided that a number of stringent conditions, designed to ensure benefit security—and that is really what we are talking about—are met.

Formal plan termination including vesting and annuitization of accrued benefits would no longer be required.

Under our proposal, an employer would be permitted to withdraw at most only assets in excess of 125 percent of the plan's termination liabilities unless benefits are insured through the purchase of annuities. Then a smaller cushion would be required. This means substantial assets above those required to fund benefits earned to date would be left in the ongoing plan. Participants will be well-protected against future investment risk, and as contemplated under current funding standards, additional assets would be retained in the plan for the funding of future benefits.

To prevent manipulation of the withdrawal mechanism and to further protect participants, we would aggregate all plans maintained by an employer. This again is a fundamental change being suggested, Mr. Chairman.

Current rules allow access to plan assets on a plan-by-plan basis. Many employers have more than one pension plan, often with different degrees of funding. What we are suggesting is that in order to terminate or withdraw from one, they have to simply take the common assets of all of those plans into consideration to be sure that we do not get into a situation where they withdraw assets from one fund that is overfunded and then leave other plans that are underfunded. That is unacceptable, and we have to deal with it. We do have that circumstance available to them now, and that is a loophole that we think has to be dealt with. The extent to which employees' benefits are funded should not depend upon whether an employer maintains one or multiple plans.

We would require that all of an employer's defined benefit plans be funded in the aggregate before an employer could withdraw assets from any one of its plans. This would give us an adequate cushion across-the-board. It would make more assets available to employers if they terminate their plans. However, the proposal discourages plan terminations by limiting the amount an employer may receive in a termination reversion to the amount that would have been obtained through a withdrawal so long as the employer continues to cover any of its employees with a defined benefit plan.

What we are saying is that we really want to discourage terminations. We really do believe that they are going to have some opportunity for withdrawal. But if they can do that and if they have multiple plans, they cannot leave one plan at risk while withdrawing from another plan.

To assure that the rules achieve their intended result, all single-employer plans, whether or not subject to collective bargaining, are included in the aggregate tests. Many employers have adequately funded their salaried worker plans while funding less adequately their plans for hourly workers. All too often, it is the rank and file employees who suffer when underfunded plans are terminated. By including collectively bargained plans, we ensure all plans receive equal treatment.

The other major problem with ERISA as currently structured comes in the category of underfunded plans, plans that are underfunded while meeting the ERISA standard of minimum funding. We have got to change that standard, Mr. Chairman, with minimum funding standards that are much tougher for all underfunded plans. The employers with well-funded plans would not be affected by these more stringent standards except that all employers would be required to make quarterly contributions to their plans.

One of the reasons for that is to let us know earlier when a plan is getting into trouble. But we do believe that when a plan is underfunded that substantial incentives and mandations should be imposed to deal with the underfunded plan.

For instance, in some cases, benefit payouts from an underfunded plan exceed required contributions to the plan. When this happens, the plan's funds are gradually dissipated. Our proposed rule would require the plan to meet a cash flow standard designed to ensure the solvency of the plan.

In addition, a second new rule would prevent the funding status of an underfunded plan from continuing to deteriorate. Whenever a plan's funding status worsens, the employer would have to make up the decline over a short period, perhaps as few as 3 years.

Under current law, regardless of a plan's funded status, new unfunded liabilities can be amortized over periods ranging from 10 to 30 years.

Third, we would require employers with seriously underfunded plans to fund existing unfunded liabilities and new unfunded benefit increases over shorter and more realistic periods of time. The more underfunded the plan and the sooner the liabilities come due, the larger the contributions and the shorter the funding period.

I cannot overemphasize the importance of these new funding rules. They will require all plans to move toward full funding. This will enhance the security of retirement benefits. They will also assure the long-term solvency of the PBGC insurance program, which will ease the days and nights of Kathy Utgoff mightily, I am sure.

Over the long term, the changes in funding standards will reduce the number of underfunded plans and the extent of underfunding in such plans and thus significantly reduce the PBGC and our Government and taxpayer exposure.

Now, we do recognize that when the plans are already underfunded, these rules will result in substantially increased contributions. We understand that that would cause some hardship, and we understand that that will require some transition rules, carefully drafted in consultation with you.

The proposal also addresses the termination of underfunded plans. Under current law, when plans are terminated, employers with well-funded plans meet their pension obligations while employers that have not funded their plans responsibly have a lesser obligation. This is unfair to workers and discourages full funding—and I should add, it is fundamentally unfair to competing businesses in the same field that have met their responsibilities.

We are proposing a uniform level of termination liability that would make all employers liable for the full benefits participants have earned as of the date of plan termination. This would mean, among other things, that both plan participants and the PBGC would be entitled to additional claims when plans are terminated.

As with withdrawals from overfunded plans, the administration would eliminate manipulation in terminating underfunded plans by applying aggregation tests. Thus, if a plan terminates with insufficient assets to pay full accrued benefits, assets would have to be transferred from any overfunded plan maintained by that employer into the terminating underfunded plan.

This will not only enhance benefit security; it will also result in the PBGC's exposure.

The final part of our proposal is designed to take a positive first step in addressing the large and growing problem of unfunded retiree health benefits.

Very few employers have set aside funds to pay for retiree health benefits. Consequently, most active and retired employees have little assurance that they will actually receive their promised retiree health benefits.

We recently estimated that the unfunded liability of these benefits is about $100 billion.

What we propose is to allow an employer to transfer all or a portion of the assets otherwise available for withdrawal from a defined benefit plan to a separate trust to provide health benefits to current retirees. This would not be subject to the 10 percent excise tax or to income tax. Income on assets transferred to the retiree health benefit fund would accumulate tax-free.

Permitting sponsors to make tax-free transfers to health benefit funds for current retirees will encourage employers to continue to provide these important benefits.

In closing, I would like to emphasize that these changes will significantly increase the probability that all plan participants will receive their full promised benefits. Employers will be free to make their own benefit promises, but they will be required to meet those commitments.

The administration proposal will improve the stability and credibility of the single-employer defined benefit pension system. It will significantly reduce the PBGC's financial exposure in the future.

And finally, I believe that our overall productivity and competitiveness will be improved by offering corporations that fund their pension obligations in a responsible manner improved access to capital that can be better used creating jobs and expanding our economy, and through a work force made more secure in their retirement.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Brock and supplemental material supplied for the record follow:]

STATEMENT OF WILLIAM E. BROCK
SECRETARY OF LABOR
TO THE SENATE SUBCOMMITTEE ON LABOR
AND
THE HOUSE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

March 24, 1987

Chairman Metzenbaum, Chairman Clay, Senator Quayle, Congresswoman Roukema and the Other Members of the Subcommittees:

I am pleased to appear before you to present the Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans. I share your strong commitment to preserving the retirement security of the millions of persons covered under private pension plans. I also am aware of the interest that you have in the formulation of a rational and equitable approach to the funding and termination of defined benefit plans.

The proposal I'm here to discuss today began in response to a Congressional directive that the Department study the termination of pension plans involving reversions of assets to employers. The proposal is the product of months of intensive work by a number of departments and agencies in the Executive Branch, and is one of the President's legislative priorities in this Congress. I request that a copy of the proposal be included in the hearing record.

I have here with me today Dennis Kass, my Assistant Secretary for Pension and Welfare Benefits, Roger Mentz, the Assistant Secretary for Tax Policy at Treasury, and Kathy Utgoff, the Executive Director of the PBGC. They are here to answer any specific questions you may have about the mechanics of the proposal. I'd like to take my time to discuss with you the major components and policy implications of the proposal.

For many American workers, the benefits provided by private pension plans are essential to a dignified, comfortable retirement. It is critical that defined benefit pension plans be funded with assets sufficient to ensure that all pension promises are kept. Our workers need to know that they will receive their promised pension benefits.

Many people believed this pension promise was secured through the enactment of the Employee Retirement Income Security Act of 1974 (ERISA). However, two disturbing trends reflect major weaknesses in the current law. The first relates to the termination of overfunded pension plans and the recovery of excess assets. The second relates to the termination of severely underfunded pension plans.

Until recently the termination of a pension plan to recover excess assets was an unusual event. In 1980, only nine significantly overfunded pension plans were terminated resulting in only $20 million of excess assets being recovered by the employers. A strong stock market and high annuity rates caused some pension plans to accumulate assets well in excess of those needed to meet their accrued pension obligations. As a result, the number of terminations with reversions escalated rapidly. In 1985, reversion activity peaked with 525 overfunded plans terminating and over $6 billion in assets reverting to employers.

Most employers who have terminated a plan to obtain a reversion have not abandoned defined benefit plans. Rather, they have reestablished very similar or identical plans. Clearly, the purpose of these terminations has been to recapture the unanticipated assets that have accumulated.

Requiring employers to terminate their pension plans in order to recover assets well in excess of those needed to maintain proper funding is inconsistent with a stable and secure pension system. There is concern that these reestablished plans, having been stripped of all assets in excess of termination liabilities, might not have sufficient assets to maintain sound funding during an economic downturn. Futhermore, without a cushion of assets, plan sponsors will be less likely to increase benefits or grant cost-of-living increases to retirees.

The second disturbing fact is the recent increase in seriously underfunded defined benefit plans due to inadequacies of the current minimum funding standards. The Department estimates the total underfunded liability of underfunded plans is about $45 billion. We believe that up to half of this underfunding is in 25 to 35 large underfunded plans. The recent terminations of some of these significantly underfunded plans have resulted in massive and growing liabilities for the PBGC. Because neither the PBGC nor the employer is responsible for all unfunded benefits when a plan terminates, these terminations have deprived many employees of the full benefits they had earned as of the date the plan terminated. For many of the large underfunded plans still in existence, it may be too late for this proposal to help. The proposal is designed to prevent these large unfunded liabilities from recurring in the future.

Many of the losses these terminations impose on plan participants and the PBGC are due to weaknesses in the current funding provisions of ERISA. In some cases, underfunded plan terminations have involved plans whose sponsors have at all times complied with the minimum funding standards of ERISA. In fact, several plans never even received a funding waiver from the IRS and still had almost no money in their plans when they were terminated. It seems incredible to me that a plan could comply fully with ERISA's minimum funding standards and yet terminate in insolvency.

To solve these two problems, Congress and the Administration must join in a cooperative effort to reform the termination and funding provisions of ERISA. A system that requires pro forma terminations to recover assets beyond those needed to fund a plan and permits the steady decay in the funding of a plan that is meeting ERISA's required annual contributions is broken and needs to be fixed. I am convinced the Administration's proposal offers an effective and comprehensive way to correct this situation.

Employers should always be allowed to terminate a plan when they no longer wish to offer a defined benefit plan to their employees. Current law forces an employer to terminate a plan in order to recover excess assets. This often results in a plan being immediately reestablished with less assets than is appropriate. The reestablished plan is exposed to greater risk of underfunding because of market fluctuations. There also is less certainty that employees will receive their expected future benefits.

The Administration's proposal would permit an employer to withdraw assets from an ongoing defined benefit plan provided that a number of stringent conditions, designed to ensure benefit security, are met. Formal plan termination, including vesting and annuitization of accrued benefits, would no longer be required.

Under the proposal, an employer would be permitted to withdraw, at most, only assets in excess of 125% of the plan's termination liabilities unless benefits are insured through the purchase of annuities. Then, a smaller cushion will be required. This means substantial assets above those required to fund benefits earned to date would be left in the ongoing plan. The participants would be well protected against future investment risk and, as contemplated under current funding standards, additional assets would be retained in the plan for the funding of future benefits.

To prevent manipulation of the withdrawal mechanism and to further protect participants, the proposal would aggregate all plans maintained by an employer. Current rules governing employer access to plan assets operate on a plan-by-plan basis.

Many employers have more than one pension plan, often with different degrees of funding. In fact, many employers maintain both overfunded and underfunded plans and are allowed to terminate an overfunded plan, and recover the excess assets, while continuing to maintain an underfunded plan. Indeed, some employers have taken "excess" assets from one plan and subsequently terminated an underfunded plan. This denies employees in the underfunded plan their full promised benefits and simultaneously transfers liabilities to the PBGC.

This is a serious loophole in the current law that must be corrected. The extent to which employees' benefits are funded should not depend upon whether an employer maintains one or multiple plans.

To close this loophole, the Administration's proposal would require all of an employer's defined benefit plans to be adequately funded in the aggregate before an employer could withdraw assets from any of its plans. Thus, there would be an adequate cushion for all the employer's plans, considered as a whole, as well as for the plan from which the withdrawal is taken.

Because of the cushion requirement on withdrawals, more assets would generally be available to employers if they terminated their plans. However, the proposal discourages plan terminations by limiting the amount an employer may receive in a termination reversion to the amount that would have been obtained through a withdrawal so long as the employer continues to cover any of its employees with a defined benefit plan. In order to obtain a reversion equal to the amount of assets above termination liabilities, an employer would have to terminate all of its defined benefit plans and fully vest and purchase annuities for all participants. In addition, that employer would be precluded from establishing a new defined benefit plan for these same employees for five years. None of these requirements would apply in the case of an asset withdrawal. They are designed to discourage employers from terminating their defined benefit plans simply to recover all assets above termination liabilities. Finally, competitive pressures, employee relations concerns and collective bargaining agreements will deter employers from terminating all of their plans simply to maximize the cash they can recover.

To assure that the rules achieve their intended result, all single-employer plans, whether or not subject to collective bargaining, are included in the aggregate tests. Many employers have adequately funded their salaried worker plans while funding less adequately their plans for hourly workers. All too often, it is the rank-and file employees who suffer when underfunded plans are terminated. By including collectively bargained plans we assure all plans receive equal treatment.

The other major problem with ERISA as currently structured is that plans can become increasingly underfunded while fulfilling the requirements of ERISA's minimum funding standards. Properly structured minimum funding standards are essential if we are to ensure that employers fulfill their pension promises.

The Administration's proposal would establish new and tougher minimum funding standards for all underfunded plans. Employers with well-funded plans would not be affected by these more stringent standards, except that all employers would be required to make quarterly contributions to their plans.

The rules for insufficiently funded plans are designed to deal with types of situations that are overlooked by current law. For instance, in some cases benefit payouts from an underfunded plan exceed required contributions to the plan. When this happens, the plan's funds are gradually dissipated. The proposed rules would require the plan to meet a cash flow standard, designed to ensure the solvency of the plan.

In addition, a second new rule would prevent the funding status of an underfunded plan from continuing to deteriorate. Whenever a plan's funding status worsens, the employer would have to make up the decline over a short period, perhaps as few as three years. Under current law regardless of a plan's funded status, new unfunded liabilities can be amortized over periods ranging from 10 to 30 years.

A third new rule would require employers with seriously underfunded plans to fund existing unfunded liabilities and new unfunded benefit increases over shorter and more realistic periods of time. The more underfunded the plan and the sooner the liabilities come due, the larger the contributions and the shorter the funding period.

The proposal also restricts the conditions under which minimum funding contribution waivers are granted. An employer would be required to demonstrate temporary hardship on a controlled group basis, pay higher interest rates, amortize waived amounts more quickly if the plan is underfunded and file a waiver request much earlier than under current law. These changes are designed to limit the availability and attractiveness of funding waivers to those cases where they are appropriate and necessary.

I cannot overemphasize the importance of these new funding rules. They will require all plans to move toward full funding. This will enhance the security of retirement benefits. They will also assure the long term solvency of the PBGC insurance program. Over the long term the changes in the funding standards will reduce the number of underfunded plans and the extent of underfunding in such plans and thus significantly reduce the PBGC's exposure.

For plans that are severely underfunded already, these rules would result in substantially increased contributions. It is our intention to minimize any short-run hardship from these provisions through carefully structured transition rules.

The proposal also addresses the termination of underfunded plans. Under current law when plans are terminated, employers with well-funded plans meet their pension obligations while employers that have not funded their plans responsibly have a lesser obligation. This is unfair to workers and discourages full funding.

The Administration is proposing a uniform level of termination liability that would make all employers liable for the full benefits participants have earned as of the date of plan termination. This would mean, among other things, that both plan participants and the PBGC would be entitled to additional claims when plans are terminated.

As with withdrawals from overfunded plans, the Administration would eliminate manipulation in terminating underfunded plans by applying aggregation tests. Thus, if a plan terminates with insufficient assets to pay full accrued benefits, assets would have to be transferred from any overfunded plan maintained by the employer into the terminating underfunded plan. This will not only enhance benefit security; it will also result in a reduction in the PBGC's exposure.

A final part of the Administration's proposal is designed to take a positive first step in addressing the large and growing problem of unfunded retiree health benefits.

Very few employers have set aside funds to pay for retiree health benefits. Consequently, most active and retired employees have little assurance that they will actually receive their promised retiree health benefits. The Department of Labor recently estimated that in 1983 the unfunded liability of such retiree health benefits was about $100 billion dollars.

The proposal would permit an employer to transfer all or a portion of the assets otherwise available for withdrawal from a defined benefit plan to a separate trust to provide health benefits to current retirees. Unlike other withdrawals and reversions, the sums transferred to retiree health accounts would be exempt from current income and the 10% excise tax. Income on assets transferred to the retiree health fund would accumulate tax free.

Permitting sponsors to make tax-free transfers to health benefit funds for current retirees will encourage employers to continue to provide these important benefits.

In closing, I would like to emphasize that these changes will significantly increase the probability that all plan participants will receive their full promised benefits. Employers will be free to make their own benefit promises but they will be required to meet those commitments. The Administration's proposal will improve the stability and credibility of the single-employer defined benefit pension system. It will significantly reduce the PBGC's financial exposure in the future. And finally, I believe that our overall productivity and competitiveness will be improved by offering corporations that fund their pension obligations in a responsible manner improved access to capital that can be better used creating jobs and expanding our economy, and through a workforce made more secure in their retirement.

THE ADMINISTRATION'S PROPOSAL ON THE FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

(Legislative Language to be Developed)

EXECUTIVE SUMMARY

I. BACKGROUND

Private pension plans constitute a major and increasingly important source of retirement income for American workers. In general, these plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). One of the primary purposes of ERISA is to assure the adequate funding of defined benefit pension plans. To this end, ERISA imposes minimum funding standards, regulates the investment of plan assets, and strictly limits employer access to such assets. In addition, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to guarantee certain benefits under defined benefit pension plans.

The rules established as part of ERISA (and subsequent amendments thereto) have largely accomplished their intended purpose. However, weaknesses remain that enable employers to act in ways that may jeopardize their ability to fulfill benefit promises they have made. Two particularly troubling trends have developed in connection with defined benefit plans that are either overfunded or underfunded in relation to their benefit obligations.

First, during the recent past, a significant number of employers have terminated their overfunded defined benefit pension plans in order to obtain, through asset reversions, the assets of plans that exceed such plans' termination liability to participants. Plan terminations are costly and disruptive. Even in the case where an employer continues to provide defined benefit plan coverage to its employees following a plan termination and asset reversion, such a transaction reduces participants' benefit security with respect to future benefit accruals and may also discourage the employer from granting ad hoc benefit increases or cost of living allowances for retirees.

Second, in spite of the minimum funding standards imposed by ERISA, many pension plans are currently underfunded to a substantial degree. Indeed, under the provisions of current law, the funding status of a plan may deteriorate even though an employer fully complies with the minimum funding standards and other requirements of ERISA. As a result, participants may not receive their full accrued benefits and the PBGC may be required to accept responsibility for some or all of such benefits.

The Administration believes that public policy should encourage optimal, rather than deficient or excessive, funding of pension obligations. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own legal liability or financial capacity to keep those promises when they come due. The purpose of sound funding is to protect participants' benefits by insulating them from the business risk of the employer, as well as to protect the PBGC insurance system from systematic loss. In addition, for purposes of both tax policy and economic efficiency, employers should not be required to fund their benefit promises beyond a level that reasonably assures that such benefits will be paid when due.

The Administration's Proposal is designed to improve benefit security for plan participants in several ways. First, employers' access to surplus assets in overfunded defined benefit plans is limited and rationalized; second, the minimum funding standards are strengthened to increase the likelihood that defined benefit plans will be funded sufficiently to provide participants' accrued benefits; and, third, employers are made more responsible and accountable for their benefit promises.

II. MAJOR POLICY CONCEPTS UNDERLYING THE ADMINISTRATION'S PROPOSAL

A. Employers should be permitted to recover excess assets from ongoing defined benefit plans provided that certain conditions are met.

The Proposal permits employers to withdraw assets from ongoing defined benefit plans provided that, following the withdrawal, a sufficient asset cushion remains in the plan and all other plans maintained by the employer and the controlled group. The Proposal generally limits the amount that an employer may recover from a plan on termination through a reversion to the amount that could have been withdrawn from such plan. However if, following the termination, the employer and the controlled group cease to maintain any defined benefit plans, the employer may recover all assets in excess of termination liability. In such event, the employer (and its controlled group) would be precluded from establishing a defined benefit plan for a period of five years.

B. The minimum funding rules and deduction limits for defined benefit plans should be modified in order to improve the benefit security of plan participants and protect the PBGC.

The Proposal is directed at improving the funded status of plans that are underfunded on a termination basis. Such plans would be subject to the following requirements: (i) more rapid amortization of certain unfunded accrued liabilities and waived contributions; (ii) rapid amortization of future declines in fundedness, and (iii) a minimum funding contribution for a year based on the plan's distributions and expenses during the year. In addition, the Proposal would establish new protections for benefit security in all defined benefit plans by (i) making the fundedness of a controlled group of plans the determining factor in deciding whether and to what extent any plan(s) included in such group may be the subject of a termination reversion or asset withdrawal transaction; (ii) accelerating the due date for minimum funding contributions; and (iii) limiting the availability and attractiveness of minimum funding waivers. Also, the Proposal would modify the tax rules to eliminate those provisions which may prevent employers from making additional contributions to remedy the underfunded status of a plan.

C. The current plan termination rules should be modified to improve the likelihood that participants will receive their full accrued benefits and to protect the PBGC.

The Proposal would make it more certain that employers will fund their defined benefit plans adequately. In addition, participants will be more likely to receive their promised benefits after termination of an underfunded plan because the employer's termination liability to participants will be increased. The Proposal would also curtail the ability of employers in certain cases to shift unfunded liabilities to the PBGC by providing for limited transfers of assets from ongoing overfunded plans to terminating underfunded plans.

D. Employers should be permitted on a tax favored basis to use assets available for withdrawal from a defined benefit plan to fund post-employment health benefits for existing retirees.

The Proposal would permit employers to transfer assets available for withdrawal from defined benefit plans to tax-favored welfare benefit trusts for payment of health benefits of existing retirees, without current tax consequences. In addition, the Proposal would repeal Code section 401(h). Assets currently set aside in a 401(h) account could be transferred without tax consequences to a tax-favored retiree health fund.

III. IMPACT OF THE PROPOSAL

The Administration Proposal will serve to better protect the pensions of American workers, safeguard the Treasury, and reduce the financial burdens imposed on the PBGC. In the opinion of the Administration, a fundamental revision of the termination and funding provisions of ERISA is the best means of minimizing the number of underfunded plans and the extent of underfunding in the defined benefit universe. This will avoid, or at least mitigate losses incurred by plan participants and the PBGC. These modifications principally will affect underfunded plans and will have a minimal impact on properly funded plans. In addition, the post-employment health transfer provision will help to ameliorate the growing problem of unfunded retiree health benefits, but will not entail additional tax expenditures.

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I. BACKGROUND

Private pension plans constitute a major and increasingly important source of retirement income for American workers. In general, these plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). One of the primary purposes of ERISA is to assure the adequate funding of defined benefit pension plans. To this end, ERISA imposes minimum funding standards, regulates the investment of plan assets, and strictly limits employer access to such assets. In addition, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to guarantee certain benefits under defined benefit pension plans.

The rules established as part of ERISA (and subsequent amendments thereto) have largely accomplished their intended purpose. However, weaknesses remain that enable employers to act in ways that may jeopardize their ability to fulfill benefit promises they have made. Two particularly troubling trends have developed in connection with defined benefit plans that are either overfunded or underfunded in relation to their benefit obligations.

First, during the recent past, a significant number of employers have terminated their overfunded defined benefit pension plans in order to obtain, through asset reversions, the assets of plans that exceed such plans' termination liability to participants. Plan terminations are costly and disruptive. Even in the case where an employer continues to provide defined benefit plan coverage to its employees following a plan termination and asset reversion, such a transaction reduces participants' benefit security with respect to future benefit accruals and may also discourage the employer from granting ad hoc benefit increases or cost of living allowances for retirees.

Second, in spite of the minimum funding standards imposed by ERISA, many pension plans are currently underfunded to a substantial degree. Indeed, under the provisions of current law, the funding status of a plan may deteriorate even though an employer fully complies with the minimum funding standards and other requirements of ERISA. Compliance with the minimum funding standards does not necessarily assure that, upon a plan termination, participants' benefits will be adequately funded. As a result, participants may not receive their full accrued benefits and the PBGC may be required to accept responsibility for some or all of such benefits.

The Administration believes that public policy should encourage optimal, rather than deficient or excessive, funding of pension obligations. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own legal liability or financial capacity to keep those promises when they come due. The purpose of sound funding is to protect participants' benefits by insulating them from the business risk of the employer, as well as to protect the PBGC insurance system from systematic loss. In addition, for purposes of both tax policy and economic efficiency, employers should not be required to fund their benefit promises beyond a level that reasonably assures that such benefits will be paid when due.

The Administration's Proposal is designed to improve benefit security for plan participants in several ways. First, employers' access to surplus assets in overfunded defined benefit plans is limited and rationalized; second, the minimum funding standards are strengthened to increase the likelihood that defined benefit plans will be funded sufficiently to provide participants' accrued benefits; and, third, employers are made more responsible and accountable for their benefit promises.

A. Asset Reversions From Overfunded Plans

Under ERISA, employers are required to fund their pension plans in accordance with minimum funding standards. These standards were developed to ensure that employers contribute sufficient assets to fund not only participants' accrued benefits, but also a portion of their projected benefits (i.e., including estimated future salary increases but not estimated future service).

Frequently, defined benefit plans that are funded in accordance with the minimum funding standards accumulate assets in excess of their termination liability to participants. Under ERISA, an employer may recover assets from a plan only if the plan is terminated and the assets of the plan exceed its termination liability. Consequently, many employers have felt compelled to terminate plans in order to gain access to excess plan assets.

Concerned that employers would completely discontinue their defined benefit plans in order to obtain assets in excess of termination liabilities, in May, 1984, the Department of Labor, the Department of the Treasury and the PBGC jointly issued the Asset Reversion Implementation Guidelines (the "Guidelines", see exhibit E). The Guidelines permit employers to gain access to excess assets without completely discontinuing their current defined benefit pension plan arrangements by allowing "termination/reestablishments" (e.g., the termination of an overfunded defined benefit plan followed by the establishment of a new defined benefit plan) and "spinoff/terminations" (e.g., the splitting of one overfunded plan into two plans: a plan with retirees and excess assets, which is terminated to enable the employer to recover the excess, and an ongoing plan with active employees and assets equal to termination liabilities).

Since the issuance of the Guidelines, many employers have been able, in effect, to "withdraw" assets from their overfunded defined benefit plans without leaving the defined benefit system. While the Guidelines have made it possible for sponsors with significantly overfunded plans to continue to offer defined benefit plans to their employees, they did not address two important problems.

First, an ongoing defined benefit plan with assets in excess of termination liabilities contains an "asset cushion" that protects the plan against adverse investment performance in the future and may be used to fund future benefit accruals and increases. Such an "asset cushion" generally is consistent with the minimum funding standards. Following a termination/reestablishment or a spinoff/termination transaction, the remaining defined benefit plan generally has no such asset cushion.

Second, because the amount of assets available to an employer on plan termination through a reversion is determined on a plan-by-plan basis, it is possible for an employer to remove assets from overfunded plans (typically, plans for salaried employees) while maintaining materially underfunded plans (typically, plans for less highly paid, hourly employees). In such situations, an employer may inappropriately benefit from the tax-favored treatment of assets that are not used to provide retirement benefits and, at the same time, leave some participants with inadequately funded benefits and perhaps shift liabilities to the PBGC.

Given the extent of overfunding in the single employer defined benefit plan system, currently estimated at a net of $218 billion on a termination basis (see exhibits B and C), and the size and number of terminations involving asset reversions, the Administration believes that there is a need for legislative action to redefine the alternatives available to sponsors in obtaining access to assets in overfunded defined benefit plans.

B. Terminations of Underfunded Plans

In recent years, there has been a marked increase in the extent to which large defined benefit plans involved in distress terminations have been underfunded (see exhibit D). These plans have not had sufficient assets to provide participants' accrued benefits and, in many cases, have not had adequate assets to provide even the level of benefits guaranteed by the PBGC. Thus, participants have lost promised benefits and the PBGC has been forced to pick up significant additional liabilities.

The Administration believes that current law does not cope in a rational manner with the problem of underfunding. First, the current minimum funding standards have been proven to be inadequate because the allowed amortization periods for certain increased costs, experience losses and funding waivers are excessive. Second, under present law, employers are not fully responsible for their benefit promises and thus are not bound and determined to fund their defined benefit plans properly. Third, in some cases, the tax laws discourage employers from contributing amounts to remedy underfunding.

C. Retiree Health Benefits

At the same time that there have been larger than expected accumulations of assets in some defined benefit plans, there has been growing concern that many employers will not be able to continue retiree health programs, which are rarely prefunded, at current benefit levels. This concern is especially great for mature firms that have experienced rapid growth in their retiree population.

Although employer-sponsored health insurance for retirees is a relatively new benefit, it is an important one for those who are fortunate enough to receive it. For retirees over age 65, it is an important supplement to Medicare, and for early retirees it is even more important because they generally do not have access either to Medicare or to affordable private individual health insurance. Currently, about 6.9 million retirees and their spouses are receiving employer-sponsored retiree health insurance and an estimated 16 percent of the population over age 65 receives supplemental health coverage through private sector employer-sponsored retiree programs. Permitting employers to use a part of their surplus pension assets to fund health benefits for current retirees is an important element of the Administration's plan to rationalize employer access to and use of surplus assets in overfunded defined benefit plans.

II. PROPOSAL

A. Employer Access to Plan Assets

1. Current Law

Current law requires that pension plan assets be used for the exclusive benefit of plan participants. However, an employer may reserve the right on plan termination to recover plan assets that are in excess of the plan's termination liability to plan participants. A plan's termination liability to participants includes (i) all vested plan benefits and (ii) unvested and contingent plan benefits "to the extent funded," including those for which the eligibility conditions have not been satisfied.

The previously cited Guidelines, etc., allow an employer, if the plan so provides and subject to certain conditions (e.g., the requirement that annuities be purchased) to terminate an overfunded defined benefit plan, recover assets in excess of the plan's termination liability and reestablish a new plan covering the same employees (i.e., a "termination/reestablishment" transaction). The Guidelines also allow an employer to engage in a "spinoff/termination" transaction. In a spinoff/termination transaction, an employer typically splits an overfunded plan into two plans, one covering retirees and containing all assets in excess of termination liabilities and a second plan covering active employees and containing assets sufficient to fund such plan's termination liability only, and then terminates the plan with the excess assets to recover the reversion.

In general, asset reversions (whether or not on account of termination) are subject to the ten percent excise tax and the regular income tax. There is a limited exception, however, for certain reversions transferred to employee stock ownership plans prior to January 1, 1989.

2. Reasons for Change

Typically, a plan remaining or reestablished pursuant to the Guidelines does not have a cushion of assets above the level of the plan's termination liability. The absence of this cushion reduces participants' benefit security with respect to future benefit accruals and may also discourage employers from granting ad hoc benefit increases or cost of living allowances for retirees.

Furthermore, it is not uncommon for an employer to have both an overfunded plan (e.g., for salaried employees) and an underfunded plan (e.g., for hourly employees.) Some employers have received reversions from overfunded plans and then terminated underfunded plans, thereby depriving some participants of their full accrued benefits and, in some cases, shifting significant liabilities to the PBGC, even though, by receiving a reversion, such employers are at the same time using tax-favored retirement funds for non-retirement purposes. Currently, there is no requirement that the ongoing plans of the employer or controlled group receiving a reversion be funded sufficiently.

3. Explanation of the Proposal

In General. The Proposal permits employers to withdraw assets from ongoing defined benefit plans provided that, following the withdrawal, a sufficient asset cushion remains in the plan and in all other plans maintained by the employer and the controlled group. The Proposal generally limits the amount that an employer may recover from a plan on termination through a reversion to the amount that could have been withdrawn from such plan. However, if the termination causes the employer (and the controlled group) to exit the defined benefit system entirely, the employer may recover all assets in excess of the termination liability of the plan. In such event, the employer would be precluded from reestablishing a defined benefit plan for a period of five years.

Asset Withdrawals. An employer would be permitted to withdraw assets from an ongoing defined benefit plan to the extent that, after the withdrawal, each of the following conditions is satisfied: (A) the value of the assets in the plan from which the withdrawal is made exceeds the "minimum benefit security level" for such plan and (B) the value of the assets in all other plans of the employer and the controlled group of which the employer is a part (excluding the plan from which the withdrawal is made) exceeds the "minimum benefit security level" for all such plans. Appropriate assumptions and methods for valuing termination liability and plan assets would be provided for purposes of these rules.

The "minimum benefit security level" would be equal to the greater of (A) the termination liability of the plan(s) plus 100 percent of the excess of the full funding liability of the plan(s) (calculated under the projected unit credit funding method) over the termination liability of the plan(s), or (B) 125 percent of the termination liability of the plan(s). A reduced cushion would be allowed for any annuitized benefits (e.g., under (A), 40 percent would be substituted for 100 percent and under (B), 110 percent for 125 percent).

In contrast to a plan termination, an asset withdrawal from an ongoing plan would not require full vesting of plan participants' benefits.

Asset Reversions on Plan Termination. Upon termination of a defined benefit plan, an employer would be entitled to an asset reversion equal to the "permissible reversion amount." If, following the termination of the plan, the employer or a member of its controlled group continues to maintain a defined benefit plan, the "permissible reversion amount" would equal the amount that the employer could have withdrawn from the plan. The remaining assets in excess of the plan's termination liability would be transferred to the remaining ongoing plan(s) under appropriate allocation rules. If, following the termination of an overfunded plan, neither the employer nor any member of the controlled group maintains a defined benefit plan, the "permissible reversion amount" would equal the excess of the terminating plan's assets over the plan's termination liability to participants.

Following the termination of an overfunded plan, an employer receiving a reversion and other members of its controlled group generally would be precluded from establishing a defined benefit plan for the same employees for a period of five years. Also, special rules would be developed to deal with certain changes in the composition of a controlled group, e.g., the acquisition of divisions and subsidiaries maintaining defined benefit plans for their own employees.

The current law rule requiring full vesting (to the extent funded) of accrued benefits under the terminating plan would be retained.

Sponsorship and Asset Transfers. A transfer of plan sponsorship beyond the controlled group of the employer would be treated as a plan termination for purposes of determining the extent to which assets in excess of the plan's termination liability may be transferred with the plan beyond the controlled group. Thus, for example, if plan sponsorship is transferred beyond the controlled group in connection with the sale of a division or subsidiary, assets in excess of the plan's termination liability would be permitted to remain in the plan only to the extent that the employer could have recovered such assets through a termination of the plan and asset reversion. Prior to the transfer of sponsorship, excess assets that would not be available to the employer on plan termination thus would have to be transferred to other defined benefit plans of the employer (or controlled group) under appropriate allocation rules.

Similarly, transfers of excess assets from a defined benefit plan to a defined contribution plan within a controlled group would be permitted only to the extent that such assets could have been withdrawn from the defined benefit plan.

Frequency Limit. After an employer has recovered assets from a plan through either a withdrawal or a reversion, neither the employer nor any member of its controlled group would be permitted to receive plan assets in a subsequent reversion or withdrawal for a period of ten years. (A transfer of excess assets to a defined contribution plan would be treated as a withdrawal or reversion for purposes of this rule.) However, if, through a reversion or withdrawal, an employer recovers less than the total amount available, such employer (or the controlled group) may recover assets in a subsequent reversion or withdrawal within the ten year period provided that the subsequent reversion or withdrawal does not exceed the lesser of (i) the excess of the total amount available at the time of the initial reversion or withdrawal over the actual amount of such reversion or withdrawal, or (ii) the amount available for reversion or withdrawal under the applicable rules at the time of the subsequent reversion.

However, in no case would an employer or controlled group be permitted to recover assets through a withdrawal or reversion on more than three occasions during any ten year period. Also, an employer would be precluded from recovering a withdrawal or reversion from a newly established plan until the plan had been in effect for ten years. However, an employer may, at any time, receive a reversion from a terminating plan if, following such reversion, neither the employer nor any member of the controlled group continued to maintain a defined benefit plan. Simultaneous recoveries from more than one plan within a controlled group would count as a single recovery for purposes of the application of the frequency limit.

Special frequency rules would be applied to deal with sales and purchases of divisions and subsidiaries with defined benefit plans and with changes in the composition of a controlled group. For example, it generally would be appropriate to exempt an employer (and controlled group) from the ten year frequency limit if it is departing entirely from the defined benefit system.

Taxation of Withdrawals and Reversions. All withdrawals and reversions would be subject to the ten percent excise tax and income tax. Similarly, all excess assets transferred from a defined benefit plan to a defined contribution plan within the same controlled group and all defined benefit plan assets transferred to a new sponsor in excess of the transferred plan's termination liability would be treated as though they were recovered by the transferring employer. Thus, such assets would be subject to the ten percent excise tax and regular income tax. Asset transfers between defined benefit plans maintained by members of the controlled group would be exempt from the excise tax and income tax.

Collectively Bargained Plans. The reversion, withdrawal and transfer rules would apply to single employer collectively bargained plans. Except in the case of determining whether an employer has exited the defined benefit system and in certain other limited cases, such rules generally would not apply to multiemployer plans.

B. Insufficiently Funded Plans

1. Minimum Funding Standards

a. Current Law

An employer that maintains a defined benefit plan is required to fund the plan in accordance with the minimum funding standards of ERISA. The minimum funding standards require that an employer contribute an annual amount sufficient to fund a portion of participants' projected benefits determined in accordance with one of several prescribed funding methods, using actuarial assumptions that are reasonable in the aggregate.

The annual amount required to be contributed under the minimum funding rules consists of two components: normal cost (i.e., a charge relating to the current year of service) and a portion of the plan's unfunded accrued liabilities (i.e., all charges other than normal costs). The portion of a plan's unfunded accrued liabilities that must be contributed for a year is determined by amortizing such liabilities as follows: amortization of unfunded past service liability existing before January 1, 1974 over 40 years; amortization of unfunded past service benefit increases created after January 1, 1974 over 30 years; and amortization of net experience losses over 15 years.

The total annual contribution must be paid to the plan no later than 2-1/2 months after the close of the year to which the contribution relates. (Treasury regulations generally have extended this due date by six months.) An employer that fails to contribute the amount required under the minimum funding standards is subject to a five percent excise tax.

If an employer is able to demonstrate that the required minimum funding contribution for a year would impose a substantial business hardship, the employer may request a minimum funding waiver from the Internal Revenue Service. Once an employer has secured a funding waiver, it must amortize the waived amount over a period of 15 years. Interest on the waived amount is equal to the rate applicable under Code section 6621(b) (i.e., the interest rate applicable to late payment of taxes).

Contributions to defined benefit plans are deductible to the extent provided in Code section 404. Contributions that are not deductible are subject to a ten percent excise tax.

b. Reasons for Change

The current minimum funding rules do not adequately assure that plans will have enough assets to pay participants' benefits when they become due. In addition, the current rules do not relate the pace of required funding to a plan's funded status or the maturities of a plan's liabilities. As a result, unfunded liabilities can build to levels that threaten the benefit security of plan participants and produce potentially large claims against the PBGC insurance program. The problem occurs mainly in plans with mature populations, large past service credits, large experience losses, substantial recent benefit increases or nonpayment of required contributions.

Finally, because the tax law prohibits deductions for certain contributions to underfunded plans and imposes a ten percent excise tax on nondeductible contributions, some employers are discouraged from improving the funded status of their underfunded plans.

c. Explanation of the Proposal

In General. The Proposal is primarily directed at improving the funded status of plans that are underfunded on a termination basis. Such plans would be subject to the following requirements: (i) more rapid amortization of certain unfunded accrued liabilities and waived contributions; (ii) rapid amortization of future declines in such a plan's funded status; and (iii) a minimum funding contribution for a year at least equal to the distributions made during the year (including administrative and investment expenses). In addition, the Proposal would improve the funding of all defined benefit plans by (a) making all members of the controlled group including the plan sponsor liable for the minimum funding contribution; (b) accelerating the due date for minimum funding contributions; and (c) limiting the availability and attractiveness of minimum funding waivers. Also, the Proposal would modify the tax rules that may discourage employers from making additional contributions to remedy the underfunded status of plans. None of these modifications would alter application of the current law full funding limit. In addition, special adjustments to these rules would be provided for plans using a spread gain actuarial method (e.g., the aggregate funding method). Finally, the special problems created by certain types of contingent benefits, such as shutdown benefits, should be considered.

Funded Ratio. Special minimum funding rules would apply to a defined benefit plan with a "Funded Ratio" of less than 100 percent. A plan's "Funded Ratio" is equal to the percentage determined by dividing the actuarial value of the plan's assets by 110 percent of the plan's termination liability to participants (calculated by using the plan's funding assumptions). For purposes of this calculation and application of the following rules, a plan's termination liability would include all fixed and contingent accrued benefits that would be provided if the plan had sufficient assets. Appropriate adjustments would be made for contributory defined benefit plans.

Existing Unfunded Accrued Liability. The Proposal would revise the amortization period for a plan's unfunded accrued liability existing on the effective date of this rule. The amortization period for any particular plan would range from a minimum of three to five years to the number of years remaining under the plan's existing amortization bases, depending on the plan's Funded Ratio and the maturity of the plan's liabilities. The applicable amortization period for a plan would be directly related to the plan's Funded Ratio, so that the higher the plan's Funded Ratio the longer the amortization period. The maturity of a plan's liabilities would represent the extent to which the plan's total projected liabilities (including past and future service benefits) are attributable to past service liabilities (determined under the plan's actuarial method). Generally, the older the plan participants and the more benefits are attributable to past service, the greater the maturity of the plan's liabilities and the shorter the applicable amortization period. It is expected that the amortization periods for many of the plans subject to this rule would not be shortened.

The determination of the applicable amortization period for a plan's existing unfunded liability would be made either by direct application of a prescribed formula or by reference to a table that would be developed to show the applicable amortization periods. Special rules will be developed to modify the treatment of certain plans in cases where required contributions under these rules would exceed reasonable limits or would create disparities in the treatment of less funded and better funded plans.

Benefit Increases. The applicable amortization period for accrued liabilities created by future benefit increases, expanded coverage, or the creation of a new plan would be determined in the same fashion as the period for existing unfunded accrued liabilities. For this purpose, the Funded Ratio of the plan would be determined immediately after the benefit increase.

Waived Contributions. The maximum amortization period for future waivers of minimum funding contributions would be the period determined by multiplying 15 years by the plan's Funded Ratio, but in no case more than 15 years. For example, the amortization period for a plan that has a Funded Ratio of 40 percent is 15 years times 40 percent, or 6 years.

Funded Ratio Maintenance Rule. If a plan's Funded Ratio falls below 100 percent or is less than 100 percent and declines further, a funded ratio maintenance amortization base would be created under the minimum funding rules. The base would be computed by multiplying the plan's termination liability after the decline in the Funded Ratio by the amount of the decline in the ratio (or, if less, the amount of the excess of 100 percent over the plan's Funded Ratio after the decline) and is to be amortized over three years (or, in the case of benefit increases under plans with higher funded ratios, over a longer period). For example, assume that a plan's termination liability is $1,000,000 and its Funded Ratio declines from 70 percent to 60 percent. The funded ratio maintenance base for this plan would be $1,000,000 times 10 percent, or $100,000; such base would be amortized over three years.

The amortization bases for benefit increases and experience losses would be adjusted to avoid duplicative amortizations.

Cash Flow Rule. If a plan's Funded Ratio is less than 100 percent, the minimum required contribution for a year would be at least an amount equal to the total distributions (including administrative and investment expenses) paid by the plan during such year. However, in no case would the contribution required under this cash flow rule cause a plan's funded ratio to exceed 100 percent. In addition, in the case of certain plans, e.g., frozen or retiree-only plans, there would be special rules limiting the contribution otherwise required under this provision.

Controlled Group Liability. The employer and each member of its controlled group would be jointly and severally liable under the minimum funding rules with respect to each ongoing defined benefit plan. (Of course, it is contemplated that certain minority shareholders of a controlled group member that is required to make a minimum funding contribution to a plan maintained by another member of the controlled group may arrange to be reimbursed or compensated through an agreement with the other members of the controlled group.) The deduction rules would be modified as appropriate to allow controlled group members to deduct contributions made to plans maintained by other members of the same controlled group.

Contribution Due Date. An employer (and controlled group) would be required to make minimum funding contributions for a year on a quarterly basis (analogous to the estimated tax rules). The total required contribution for a year would have to be made within 2-1/2 months after the close of the plan year. Failure to make a contribution by the applicable due date would result in application of the five percent excise tax.

Minimum Funding Waivers. An employer would be required to file a funding waiver application with respect to a plan year within 2-1/2 months after the close of the plan year. The standards for determining whether an employer is facing a substantial business hardship would be clarified so that it is clear that funding waivers are limited to temporary hardship cases; the burden would be placed on the employer to demonstrate hardship and to prove that the hardship is temporary. Because all members of the controlled group containing the plan sponsor would be liable under the minimum funding rules, hardship determinations would be based upon the circumstances of the entire controlled group, rather than merely the circumstances of the employer maintaining the plan.

The interest rate required on waived contributions would be increased to the greater of the plan rate or the market rate for loans to distressed companies (e.g., a rate based on a B bond rating by Standard and Poors, or an equivalent rating by another rating service). To protect plans against protracted periods of serious underfunding and against serious deterioration of their funded statuses, the number of annual waivers that could be granted with respect to any plan within a fifteen year period would be reduced from five to three. To assure that participants are aware of the potential loss of contributions to the plan, employers would be required to notify plan participants and beneficiaries of any funding waiver application and to provide them with an opportunity to comment. Finally, additional restrictions on funding waivers, designed to ensure that they are granted only when absolutely necessary, should be considered.

Deduction Limits. The deduction limits would be revised to allow a deduction for a defined benefit plan contribution in excess of the otherwise applicable deduction limits to the extent that such contribution does not cause either the plan's assets to exceed the plan's termination liability or the assets in all plans of the controlled group to exceed the total termination liability of the controlled group's plans. This modification would also have the effect of waiving the ten percent excise tax on such contributions. Finally, appropriate rules would be developed to prevent use of the new minimum funding rules to gain inappropriate deductions.

2. Plan Investment in Employer Securities

a. Current Law

An employee benefit plan may acquire and hold securities issued by the plan sponsor only if such securities are "qualifying" employer securities. In general, any employer stock is treated as a qualifying employer security, but debt obligations of the plan sponsor are treated as qualifying only if they are "marketable obligations" (i.e., debt obligations which are part of an issue a substantial portion of which is sold to investors who are independent of the sponsoring employer). Most plans, including defined benefit plans, are subject to an additional rule under which the plan may not acquire qualifying employer securities in an amount in excess of ten percent of plan assets. These rules are intended to limit the risks to which a plan would be exposed through investments in the plan sponsor. Most individual account (defined contribution) plans, however, may qualify as "eligible individual account plans." These plans may invest up to 100 percent of their assets in qualifying employer securities.

b. Reasons for Change

Many employers have issued stock to their employee benefit plans that has features that are substantially different from stock issued by the employer to other investors. In many cases, these special classes of stock are similar to debt obligations. Proper valuation of such stock is difficult, especially in the case of closely held corporations. Because the current law ownership tests applicable to marketable debt obligations do not apply to employer stock, there are no independent safeguards with respect to such valuations. In addition, because these special classes of stock may never have been subject to a "market test" (i.e., confirmation of valuation by means of investments by independent interests) and can be held exclusively by the plan, plan investment in such stock may involve increased risks to plan participants and the PBGC.

In addition, some employers maintain "floor-offset" arrangements that combine defined benefit and defined contribution plan features. Under such arrangements, a participant's benefit under the defined benefit portion of the arrangement is reduced by the benefit provided to such participant under the defined contribution portion of the arrangement. Many employers take the position that the defined contribution portion of the arrangement is an eligible individual account plan and argue that all, or substantially all, of the participants' individual accounts may be invested in employer securities. However, in such situations, the security of the participants' defined benefit promise is substantially weakened and the risk of loss to the PBGC is greatly increased.

Although the Internal Revenue Service has ruled that floor-offset arrangements may meet the qualification requirements of the Internal Revenue Code, the Department of Labor has not ruled that the individual account portions of these arrangements qualify for the eligible individual account plan exemption from the percentage limitations on acquisitions of qualifying employer securities.

c. Explanation of the Proposal

In General. The Proposal would tighten and clarify provisions in the law governing plan investment in employer securities.

Plan Investment in Employer Securities. The rules governing the investment of plan assets in employer securities would be modified by extending to employer stock the current law ownership limits applicable to marketable obligations under ERISA section 407(e)(2). The current law provisions relating to employer stock investments by eligible individual account plans would be retained (i.e., eligible individual account plans would be permitted to invest in any class of employer stock).

Application of the rules limiting the acquisition and holding of employer securities and employer real property (ERISA section 407) would be clarified and modified with respect to floor-offset arrangements as follows: (i) the individual account portion of a floor-offset arrangement would be subject to the ten percent limitation with respect to acquisitions of qualifying employer securities or qualifying employer real property; and (ii) existing investments in qualifying employer securities or qualifying employer real property by the individual account portion of a floor-offset arrangement in excess of ten percent of plan assets would be permitted for a specified period under rules similar to those in section 407(a) of ERISA.

3. Terminations of Underfunded Plans

a. Current Law

If a terminating defined benefit plan has assets that are insufficient to cover its termination liability, the employer may terminate the plan without any continuing legal obligation to provide participants' unfunded accrued benefits, provided that the plan has sufficient assets to cover its "benefit commitments." Benefit commitments generally refer to all vested, accrued pension benefits for which all eligibility conditions have been satisfied as of the date of termination.

If the terminated plan has assets that are insufficient to fund benefit commitments, the plan may be terminated voluntarily only in a distress termination (i.e., the employer must be in financial distress). In such a case, the employer is liable to a termination trust maintained for the benefit of the participants for the lesser of 75 percent of the unfunded benefit commitments or 15 percent of the total unfunded and funded benefit commitments. The priority status of the claim of such a termination trust is determined under generally applicable bankruptcy principles. The law requires that payments to the trust be in accordance with negotiated terms. Any amounts collected with respect to this claim are distributed to participants as collected, after payment of the trust's administrative expenses, without regard to the normal allocation priorities of ERISA.

If a terminating plan does not have assets sufficient to fund "PBGC guaranteed benefits," the employer is liable to the PBGC for the greater of (i) 100 percent of the unfunded PBGC guaranteed benefits, up to 30 percent of the employer's (and controlled group's) net worth, or (ii) 75 percent of the unfunded PBGC guaranteed benefits. The former claim of the PBGC has the status of a Federal tax lien for bankruptcy purposes; the priority status of the latter claim is determined under generally applicable bankruptcy rules. In addition, the PBGC is required to negotiate terms for payment of the claims over an extended period of time.

These rules apply to the termination of an underfunded defined benefit plan without regard to whether, at the time of termination, the employer (or controlled group) also maintains one or more overfunded plans.

b. Reasons for Change

The current rules applicable to an employer terminating an underfunded defined benefit plan do not impose a continuing liability on the employer for the plan's unfunded termination liability to participants, provided that the plan has sufficient assets to fund benefit commitments. Moreover, though a plan may have insufficient assets upon termination to satisfy benefit commitments, the employer is not necessarily liable to participants or the PBGC for the full funding shortfall. As a result of these rules, employers have little incentive to fund a plan beyond the level of benefit commitments. This in turn makes it more likely that participants will not receive their full promised pension benefits and that the PBGC will have to provide unfunded guaranteed benefits.

c. Explanation of the Proposal

In General. The Proposal would improve the likelihood that employers will adequately fund their defined benefit plans and that participants will receive their promised benefits after termination of an underfunded plan by making an employer's termination liability to participants equal to the plan's termination liability to participants. (This is consistent with the FASB rules requiring an employer to account for plan liabilities.) In addition, the Proposal would reduce the extent to which an employer may improperly shift unfunded benefit liabilities to the PBGC. The Proposal also would reduce the incidence of such terminations by providing for limited transfers of assets from ongoing overfunded plans to terminating underfunded plans.

Employer's Termination Liability. The required plan asset level for a standard termination would be increased from the current law requirement of "benefit commitments" to the full level of the plan's termination liability to participants. For this purpose, the plan's termination liability would include all fixed and contingent accrued benefits that would be provided if the plan had sufficient assets.

A defined benefit plan with assets insufficient to provide its termination liability to participants would be unable to terminate unless the employer (and controlled group) could satisfy the criteria for a distress termination. In a distress termination, the employer's (and controlled group's) liability would be increased from the current law percentage of benefit commitments to the full amount of the plan's unfunded termination liability to participants. (This would not change the priority status of the persion claims in bankruptcy.) Assets collected to satisfy the employer's liability would be allocated in accordance with the current law allocation rules, except that the value of PBGC's claim for 30 percent of net worth would be allocated exclusively to unfunded guaranteed benefits.

Termination of Underfunded Plans. If a plan terminates with assets less than the plan's termination liability, assets would have to be transferred from other plans of the controlled group to the terminating plan, under appropriate allocation rules, to the extent necessary to cover the termination liability of the terminating plan. However, assets may not be transferred from an ongoing plan to the terminating plan to the extent that the transfer would reduce the assets in the ongoing plan to less than the termination liability of such plan. A transfer of a plan with assets less than its termination liability to a sponsor outside of the controlled group would be treated as a termination of the transferred plan for purposes of this rule. (Special provisions would be developed to take into account the relative benefit levels of the underfunded and overfunded plans and to protect against manipulation of this rule through benefit increases.)

Plan Reestablishments. Except to the extent permitted by the PBGC, an employer (and its controlled group) would be precluded from establishing retirement programs which, in whole or in part, provide substantially similar benefits within five years after termination of a plan that did not have adequate assets to provide PBGC guaranteed benefits.

C. Retiree Health Benefits

1. Current Law

Employers may provide limited tax-favored funding for retiree health benefits using one of two vehicles: (i) a trust established under Code section 401(h), or (ii) a welfare benefit fund described in Code section 419.

A trust established under section 401(h) of the Code must be established incidental to a pension plan and the retiree health benefits provided thereunder must be subordinate to the pension benefits provided by the plan. Contributions to a 401(h) trust established in conjunction with a pension plan are limited to 25 percent of pension contributions and are subject to the overall limits of benefits and contributions under section 415 of the Code. Income on reserves set aside under section 401(h) is exempt from taxation.

Funds for retiree health benefits may also be set aside in a welfare benefit fund described in Code section 419. An employer may make annual deductible contributions to a fund for retiree health benefits. The maximum amount of such contributions is based on the average remaining working lives of the employees and is actuarially determined using assumptions that are reasonable in the aggregate and subject to the constraint that future benefits must be determined on the basis of current medical costs. However, income on assets set aside in a welfare benefit fund for retiree health benefits are treated as unrelated business income of the fund subject to tax.

2. Reasons for Change

Very few employers have set aside funds for health benefits for current retired employees or retiree health benefits for current active employees. As a result, most active and retired employees have little assurance that they will receive, or will continue to receive, retiree health benefits from their employers.

Favorable treatment of transfers of defined benefit plan assets to retiree health funds may induce some employers, who are permitted to withdraw assets from their defined benefit plans, to transfer such assets to retiree health funds to help fund a part of the cost of health benefits for current retirees. Such transfers would increase the security of these benefits for current retirees and, at the same time, would offer employers increased flexibility with respect to the use of excess defined benefit plan assets.

3. Explanation of the Proposal

In General. The Proposal would permit employers to transfer defined benefit plan assets available for withdrawal to a tax-favored health fund for current retirees without current tax consequences. In addition, the Proposal would repeal Code section 401(h); assets currently set aside in a 401(h) account could be transferred without tax consequences to a tax-favored retiree health fund.

Transfers to Retiree Health Funds. An employer would be permitted to transfer all or a portion of the assets available for withdrawal from a defined benefit plan to a retiree health welfare benefit fund to provide health benefits to current retirees. Such a transfer would not be subject to the 10 percent excise tax on asset withdrawals and reversions and would be exempt from current income tax. However, such a transfer would be counted as a withdrawal for purposes of the frequency limit on withdrawals and reversions.

Defined benefit plan assets that are transferred to a retiree health fund would be subject to various restrictions. First, the transferred assets could only be used to provide health benefits to employees who had retired and were covered by an employer-maintained health plan at the time of the transfer. Second, the transferred assets would not be permitted to exceed the present value of the employer's liability for health benefits for such current retired employees. Appropriate rules for calculating such present value would be developed to prevent inappropriate overfunding of the retiree health fund. Special rules would also assure that an employer's current law liability to provide a particular type or level of retiree health benefits is not altered by such a transfer.

Income on assets transferred under this rule to a retiree health fund would be exempt from both income tax and unrelated business income tax if such assets are held in a segregated welfare benefit fund to which no other amounts are added (other than transfers of 401(h) assets).

Elimination of 401(h) Accounts. Accounts maintained under Code section 401(h) would be eliminated. Thus, tax-favored employer funding of retiree health benefits would be permissible only under welfare benefit funds in accordance with the rules of Code section 419. Existing assets in 401(h) accounts could be transferred without adverse tax consequences, however, to a retiree health fund of the type to which excess defined benefit plan assets may be transferred, including a retiree health fund to which such excess assets have been transferred. Such transferred 401(h) assets would be subject to the same rules applicable to transferred defined benefit plan assets.

D. Effective Dates and Transition Rules.

The new rules included in the Proposal generally would be effective for years beginning after December 31, 1987. In order to prevent transactions which would be entered into in anticipation of the adoption of the Proposal, certain rules will be effective earlier (e.g., the rules limiting the assets available to an employer upon a plan termination through a reversion and the rules relating to plan investments in employer securities). Where appropriate, transition rules will be developed.

EXHIBIT A

SUMMARY OF ASSET REVERSION CASES, 1980-1986

Year	Number of Plans	Number of Participants	Reversions (in millions)
1980	9	22,242	$ 18.4
1981	35	30,512	159.0
1982	83	124,321	407.5
1983	162	165,005	1,579.2
1984	330	386,380	3,513.2
1985	525	686,969	6,171.4
Total	1,144	1,415,429	$ 11,848.7

Notes: Only includes plan terminations (including pending cases) with a reversion of $1 million or more. Numbers of participants are not adjusted to include ongoing plan participants in spinoff-terminations.

Source: PBGC Case Processing System and Case Files (1980-1985).

EXHIBIT B

EXTENT OF OVERFUNDING IN SINGLE-EMPLOYER DEFINED BENEFIT PLANS
(Dollars in billions)

	12/31/83	12/31/84	12/31/85	7/10/86	12/31/86
ASSETS	$560	$607	$759	$878	$876
LIABILITIES	$415	$450	$520	$627	$658
FUNDING RATIO	1.35	1.35	1.46	1.40	1.33
EXCESS ASSETS	$145	$157	$239	$251	$218
PBGC RATE	9.5%	10.0%	9.0%	7.5%	7.5%

NOTE: Liabilities were adjusted by 7.7% for each 1 percentage point change between the PBGC interest rate and the plan interest rate. 1983 are actual numbers based on Form 5500 Series data. Data for 1984 and later years are estimates.

EXHIBIT C

Estimated Underfunding and Overfunding of Single-Employer Defined Benefit Plans By Industry, 1986

(millions of dollars)

A. All Industries	Unfunded Liabilities in Underfunded Plans	Excess Assets in Overfunded Plans	Net Excess Assets
Agriculture	$ 92	$ 1,063	$ 971
Mining	288	4,980	4,692
Construction	111	1,735	1,624
Manufacturing	36,947	137,415	100,468
Transportation	2,667	9,652	6,985
Communications and Utilities	2,713	23,605	20,892
Wholesale and Retail Trade	612	11,386	10,774
Finance, Insurance and Real Estate	670	38,825	38,155
Services	527	19,976	19,449
Tax-Exempt organizations	534	8,427	7,893
Industry unknown	169	6,266	6,097
Total	$45,330	$263,330	$218,000

B. Manufacturing Industry	Unfunded Liabilities in Underfunded Plans	Excess Assets in Overfunded Plans	Net Excess Assets
Food	$ 928	$ 9,193	$ 8,265
Textiles and Apparel	269	3,350	3,081
Lumber and Paper	816	5,994	5,178
Printing	199	5,376	5,177
Chemicals	391	18,492	18,101
Petroleum	650	15,131	14,481
Rubber	1,899	2,250	351
Leather	94	309	215
Stone	1,165	2,656	1,491
Primary **metals**	10,079	4,047	-6,032
Fabricated **metals**	2,374	7,384	5,010
Machinery	3,298	35,184	31,886
Trans. equipment	14,267	18,634	4,367
Measuring instruments	518	9,415	8,897
Total	$36,947	$137,415	$100,468

Source: DOL/PWBA Office of Research and Economic Analysis. Estimates are for December 31, 1986.

EXHIBIT D

SUMMARY OF INSUFFICIENT PLAN TERMINATIONS GUARANTEED BY THE PBGC
1974 TO 1986
(Dollars in millions)

DATE OF TERMINATION	NUMBER OF PLANS	GUARANTEED BENEFIT LIABILITY	PLAN ASSETS	TOTAL FUNDING INSUFFICIENCY	AGGREGATE FUNDING RATIO	AVERAGE INSUFFICIENCY PER PLAN ($ in 000'S)
7/1/74 to 6/30/75	98	55.8	19.4	36.4	0.35	371
7/1/75 to 9/30/76	172	88.4	44.3	44.1	0.50	256
10/1/76 to 9/30/77	129	51.8	21.0	30.8	0.41	239
10/1/77 to 9/30/78	100	124.6	45.6	79.0	0.37	790
10/1/78 to 9/30/79	81	81.5	32.4	49.1	0.40	606
10/1/79 to 9/30/80	106	180.1	81.8	98.3	0.45	927
10/1/80 to 9/30/81	132	165.8	71.2	94.6	0.43	717
10/1/81 to 9/30/82	126	438.7	174.2	264.5	0.40	2,099
10/1/82 to 9/30/83	124	441.7	226.1	215.6	0.51	1,739
10/1/83 to 9/30/84	84	62.9	24.1	38.8	0.38	462
10/1/84 to 9/30/85	39	265.1	74.9	190.2	0.28	4,877
TOTAL	1,191	1,956.4	815.0	1,141.4		

EXHIBIT E

ASSET REVERSION IMPLEMENTATION GUIDELINES ISSUED IN MAY 1984

The following has been adopted by the Department of the Treasury, the Department of Labor and the Pension Benefit Guaranty Corporation to provide guidelines for processing defined benefit pension plan terminations involving asset reversions to the plan sponsor.

1. In accordance with current law, when an employer terminates a defined benefit pension plan, it may not recover any surplus assets until it has fully vested all participants' benefits and has purchased and distributed annuity contracts, to protect participants against the risk that their accrued benefits may be jeopardized by future market fluctuations or other factors.

2. At present, upon plan termination, employers can make lump sum payments to certain participants. In some cases, these lump sums have been calculated on the basis of interest rates that are higher than those available to individuals, thereby reducing the value of those benefits. This problem must be addressed. If employees are offered lump sum payments in lieu of future pensions, the amount of the lump sum must fairly reflect the value of the pension to the individual. The Pension Benefit Guaranty Corporation is developing guidelines for determining appropriate lump sum values.

3. An employer that terminates a sufficient defined benefit pension plan may establish a new defined benefit plan covering the same group of employees. The new plan may grant past service credit for the period during which an employee was covered by the terminated plan (subject to the limitations of Section 415 of the Internal Revenue Code). The prior plan and the new plan, in combination, may provide benefits for each participant equivalent to those to which the participant would have been entitled if the prior plan had continued without interruption. The PBGC will clarify the fact that a successor plan is exempt from the five year phase-in of benefit guarantees that applies to newly established plans. The above is one example of what will be deemed a successor plan by the PBGC.

4. In the case of a so-called "spin-off/termination", generally no termination will be recognized and any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

* The benefits of all employees (including those covered by the ongoing plan) must be fully vested and nonforfeitable as of the date of termination.

* All benefits accrued as of the date of termination in the ongoing plan must be provided for by the purchase of annuity contracts which represent irrevocable commitments for the benefit of each individual participant.

* All employees who were covered by the original plan must be given advance notice of the transaction in similar time and manner as if the entire original plan were being terminated.

5. In the case of a so-called "spin-off/termination" and a so-called "termination/re-establishment" transaction, generally any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

(a) In the case of an ongoing plan described in number 4 above, the funding method for the ongoing plan must be changed on the date of termination by combining and offsetting amortization bases in accordance with §412(b)(4) of the Code. The amortization period for this base will be the lesser of the combined amortization period and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method.

(b) In the case of a new plan established with credit for past service as described in number 3 above, in order to obtain a reversion of surplus assets from the terminated plan, the future amortization period for the unfunded past service liability for the new plan, under Section 412 of the Code, will be the lesser of 30 years and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method for the new plan.

The agencies' analysis indicates that, in spinoff/terminations where the conditions in numbers 4 and 5a are satisfied, the security of participants' benefits is protected by the purchase and distribution of annuities, the statutory minimum funding rules, including the rules described in number 5(a), and PBGC insurance coverage.

6. Employers are reminded that one of the requirements for plan qualification is that the plan be intended to be permanent. In any case, the funding rules generally require that plan funding be on a going-concern basis rather than on a termination basis. Thus, the tax consequences of multiple "termination/re-establishments" or "spin-off/terminations" are unaffected by these guidelines and will be determined without regard to whether the specific guidelines described above are satisfied with regard to each of the transactions. Generally, an employer may not engage in either a termination/re-establishment or spin-off/termination transaction, involving reversion of assets, any earlier than 15 years following any such transaction.

7. The federal income tax consequences of the receipt of reversions, of deductions for contributions to ongoing or successor plans and of the funding of such plans, after the change in funding method, are unaffected by these guidelines.

8. The PBGC will continue to process and the IRS will now proceed to process all pending termination cases.

Senator **Metzenbaum**. Thank you very much, Mr. Secretary.

We do indeed commend you for coming forth with this proposal. I think you are aware of the fact that there are some problems with it. I think it is imperative that those of us in the Congress who are as anxious as you to move a bill try to work out those problems. It will not be an easy task. There is some concern of labor groups, management groups, others who are concerned about your proposal, but I think everyone would agree that it is a good start, and we are prepared to work with you and your team to try to bring about a result that can go through the Congress. I think if it becomes very controversial, it will be hard to move it, but if we can come to an agreement, I think it will move quite rapidly.

I do have some questions. Workers and retirees bear the risk of plans that become underfunded because of poor investment performance. They receive cutbacks when the PBGC assumes a terminated plan. Yet they do not share in those cases where there is better-than-expected performance and the plan is terminated.

Under your proposal, when there is a surplus it all goes to the employer. In fact, companies will be reporting to the shareholders a pension liability that is more than the company will in fact pay them on a termination.

The real question is: Whose money is it, and why do workers and retirees bear the risks, but they are not permitted to share in the gains? I have never quite been able to understand this longstanding discussion that we have had with your Department on this issue as to the rights of the workers when the funds go up, when there is a matter of overfunding but an acceptance of a substantial loss—when the funds go down, and the fund has to be turned over to the PBGC. I wonder if you would address yourself to that question?

Secretary **Brock**. Yes, two points. First, the Congress wrote the law, Senator, and the Congress said that these plans in effect are owned by the corporations.

The law is abundantly clear insofar as the basic responsibilities and benefits. These are defined benefit plans. They are different from defined contribution plans. Defined benefit plans are plans in which the employer makes a commitment to achieve a certain benefit level, and that is the commitment. That is what the plan is all about.

It is my own belief that one of the weaknesses of the 1974 act is that they did not take into consideration the fact that there would be both overfunded and underfunded plans. By the way, most plans are very well-run in this country. I do think we have to understand that we are talking about the smallest element of the problem, not the largest element. Most plans are run with integrity and ability in this country and to the benefit of both sides.

Senator **Metzenbaum**. I think we would agree with that.

Secretary **Brock**. So we are dealing with a minority circumstance. But let us take that circumstance and say that there are not sufficient incentives in the law or mandations to try to maintain as stable a plan on the basis of actuarial requirements as we would like.

When we say that we want to require 125 percent of the assets to be held and only an amount above that be used for withdrawal, we are saying in effect that we want some additional security for workers. And that is precisely why we are making that proposal. So in effect, we are agreeing with the ethic of that.

But the Congress did make it abundantly clear when they wrote that law, that title, that ownership of these plans in effect did reside with the corporation that made the contribution.

Senator **Metzenbaum**. I must take issue with you in that, because I think I asked Mr. Kass when he was in to see me if he could give me a specific reference to that effect. The law does provide that the plans are to be managed for the exclusive benefit of participants. And when you permit this overage to go to the employers, it is obvious that that is not for the benefit of the participants.

Secretary **Brock**. Well, Senator, the law also provides that the plans can be terminated, and those excess assets can be taken out. These companies are not operating outside the law; they are operating entirely within the law. That is one of the problems we have, and that is what we are trying to address.

Senator **Metzenbaum**. You will recollect that when they first started down this road, the administration threw up a halt sign and said no way. And then some at the Cabinet level decided as a policy matter to reverse that position. So I do not think you can say that it is clear that they had the right to terminate and run off with the funds, because even the Administration was originally with us on this issue, and then there was that reversal of position.

So it says that they may terminate, but it does not say that the funds then belong to the employer.

Mr. **Clay**. Will the Senator yield?

Senator **Metzenbaum**. Certainly.

Mr. **Clay**. If it is your opinion that they are operating within the law, if the law is unfair to those who have contributed to the fund, and you have made all of these other recommendations to correct deficiencies in the law, why did you not make a recommendation to correct that deficiency?

Secretary **Brock**. We have.

Mr. **Clay**. Where? I do not see it.

Secretary **Brock**. When we suggest that 125 percent of the assets have to be covered prior to any withdrawal, that you can only withdraw above that amount.

Mr. **Clay**. I do not think that is an adequate redress of the problem. I will get to that on my own time.

Secretary **Brock**. Okay.

Senator **Metzenbaum**. Let me go on. According to Labor Department data, at least 60 percent of the time, companies will get more back on a termination reversion than on a withdrawal under your proposal.

Don't you think that such a proposal will provide an incentive for companies to terminate their pension plans instead of withdrawing assets?

Secretary **Brock**. No. I really do not. We are trying to make it more difficult to terminate and more burdensome. These plans are put into effect for a reason. It is good personnel policy, it is good management policy, it is good business to have a pension plan. Not only do we try to make it more difficult, but we say that if you do terminate and withdraw these assets, you cannot come back with another plan for five years. There are very few companies that I can imagine that would undergo that kind of agony.

What we are trying to say is that there has to be some alternative to termination. Let me correct one other thing that I think is a little bit of a misunderstanding.

These employers are liable; they are burdened when they do not perform up to standard. In the case of a plan termination or liquidation of a company, we have in PBGC a recapture opportunity that does put the burden on the company, so that it really is wrong to say that the employees carry the whole burden of this thing. That is not true.

Senator METZENBAUM. Your proposal prohibits companies from establishing any type of an arrangement which makes up for losses when an underfunded plan is terminated. This means that when retirees lose benefits, they are promised when they retire early or if a plant is shut down, the company cannot negotiate any follow-on program to help them out.

Now, Wheeling Pittsburgh Steel is currently litigating this issue with the PBGC, and it has been discussed as a way of helping those LTV retirees who have lost benefits. Why do you want to penalize workers and retirees for the poor funding decisions made by management, and why shouldn't a union be able to give up something at the table in exchange for taking care of the retirees?

Secretary BROCK. Why didn't they do that at the front end?

Senator METZENBAUM. Pardon?

Secretary BROCK. Why didn't they do it to begin with? Why didn't management make some more intelligent decisions to begin with? Why do they think they can always unload their burdens on the PBGC and let the taxpayers pick up their competitive disadvantage?

Senator, it is wrong to have these companies using chapter 11 to dump their pension obligations on the Federal Government and then by that, acquire an unfair competitive asset to be used against the good companies——

Senator METZENBAUM. We are in agreement on that.

Secretary BROCK. All right. Why should we give them anything when they do that?

Senator METZENBAUM. We would not be giving them anything. What we are trying to do is to let management and the union work out this kind of an arrangement. It would not adversely affect the PBGC if we were to permit that to occur.

Secretary BROCK. Why don't we let them take care of their obligations to PBGC first; then I would view it with a good deal more favor.

Senator METZENBAUM. You are saying that they cannot negotiate any follow-on program to help them out. And if the company and the union are willing to, and they are paying the PBGC their required funds and they are solvent, I do not know why you would prohibit them under those circumstances?

Secretary BROCK. But they are not solvent. They are in chapter 11.

Senator METZENBAUM. Wheeling Pitt is definitely in chapter 11.

Secretary **Brock**. Yes. So they are not solvent. If they want to belly up and start doing what they should have done to begin with, fine. But let us do that first.

Senator **Metzenbaum**. I will just ask one more question and then turn it over to my colleagues.

Later, we will hear from a representative of workers and retirees from Reeves Brothers. Their company was acquired by Schick, Inc. Part of the $100 million loan agreement which financed the takeover was made with a consortium of banks which mandated the termination of the pension plan, $20 million of the surplus assets going to the banks. The banks tell us this is not an unusual arrangement.

I will place in the record at this point letters that Congressman Clay and I have sent and the responses we have received on that subject.

[The letters referred to follow:]

Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Robert E. Linton
Chairman
Drexel Burnham Lambert Inc.
60 Broad Street
New York, NY 10004

Dear Mr. Linton:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues, our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution was identified as the financial adviser to an unusual loan agreement requiring such plan terminations. Last May, Drexel, Burnham, Lambert, served as counsel to a consortium of nine lenders, which structured a loan to aid a merger between Schick, Inc. and Reeves, Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to the lending institutions as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a reversion of the excess assets in the Reeves hourly employees plan will soon follow. It appears noteworthy in these events that a Vice President from your firm, Edmond D. Franco, presently serves as an outside director to Schick Inc.

Our respective Congressional committees have never come across such a situation in which pension terminations are mandated by a loan convenant. Given the fact that Schick Inc. is not in or near Chapter 11 proceedings, we cannot help but wonder why outside financial institutions might be advised to exercise such an claim on pension plan assets.

As a result of the unusual circumstances surrounding the Reeves pension terminations, we have invited a Reeves employee to testify at our March 24th hearing. We are also very much interested in obtaining the perspective of Drexel, Burnham, Lambert, as the financial adviser to the loan agreement requiring these reversions. Our two Congressional Committees, therefore, invite your written comments as soon as possible on the motives and circumstances surrounding the current Reeves pension terminations.

Sincerely

Howard M. Metzenbaum

Howard Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill Clay

William L. Clay
Chairman
Subcommittee on Labor-
Management Relations
Committee on Education and
Labor

Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Paul A. Willax
Chairman
Empire of America, FSA
One Main Place
Buffalo, NY 14202

Dear Mr. Willax:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, Empire of America, FSA, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

Our respective Congressional Committees have never come across such a situation in which pension terminations are mandated by a loan covenant. Given the fact that Schick, Inc. is not in or near Chapter 11 proceedings, we cannot help but wonder why outside financial institutions are trying to exercise such an claim on pension plan assets.

Because of the unusual circumstances surrounding the Reeves pension terminations, we have invited a Reeves employee to testify at our March 24th hearing. We are also very much interested in obtaining the perspectives of the lending institutions requiring these terminations and reversions. Our two Congressional Committees, therefore, invite your written comments on the motives and circumstances surrounding the current Reeves pension terminations.

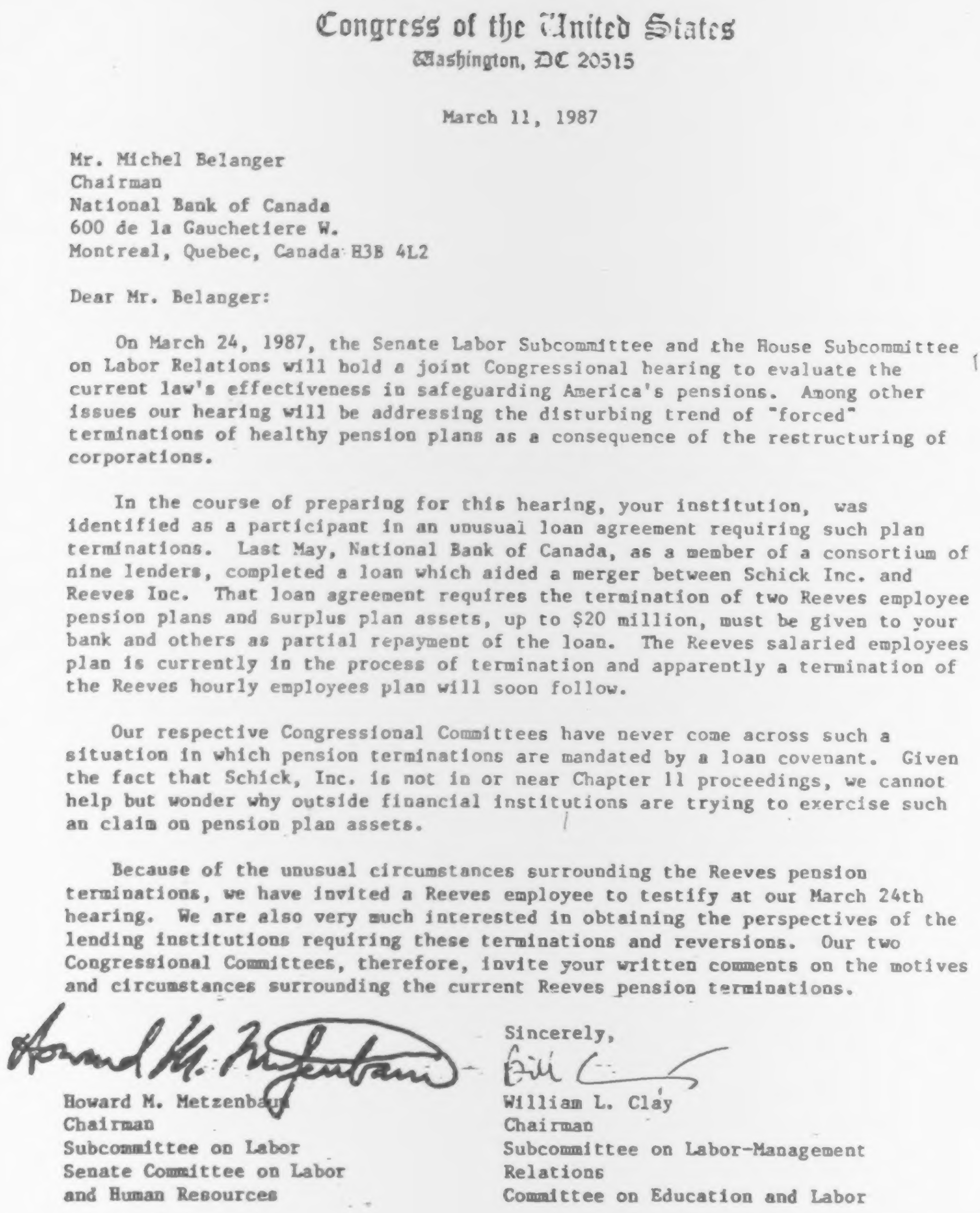
Sincerely,

Howard M. Metzenbaum

Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill

William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor



Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Michel Belanger
Chairman
National Bank of Canada
600 de la Gauchetiere W.
Montreal, Quebec, Canada H3B 4L2

Dear Mr. Belanger:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, National Bank of Canada, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

Our respective Congressional Committees have never come across such a situation in which pension terminations are mandated by a loan covenant. Given the fact that Schick, Inc. is not in or near Chapter 11 proceedings, we cannot help but wonder why outside financial institutions are trying to exercise such an claim on pension plan assets.

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Sincerely,

Howard M. Metzenbaum
Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill Clay
William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

Congreſs of the United States
Washington, DC 20515

March 11, 1987

Mr. William T. Knowles
Chairman
National Westminster Bank, USA
175 Water Street
New York, NY 10038

Dear Mr. Knowles:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, National Westminster Bank, USA, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

Our respective Congressional Committees have never come across such a situation in which pension terminations are mandated by a loan covenant. Given the fact that Schick, Inc. is not in or near Chapter 11 proceedings, we cannot help but wonder why outside financial institutions are trying to exercise such an claim on pension plan assets.

Because of the unusual circumstances surrounding the Reeves pension terminations, we have invited a Reeves employee to testify at our March 24th hearing. We are also very much interested in obtaining the perspectives of the lending institutions requiring these terminations and reversions. Our two Congressional Committees, therefore, invite your written comments on the motives and circumstances surrounding the current Reeves pension terminations.

Sincerely,

Howard M. Metzenbaum
Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill
William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Clifford A. Cutchins
Chairman
Sovran Financial Corporation
One Commercial Place
Norfolk, VA 23501

Dear Mr. Cutchins:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, Sovran Financial Corporation, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

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Sincerely,

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Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill

William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

Congreſs of the United States
Washington, DC 20515

March 11, 1987

Mr. R.D. Fullerton
Chairman
Canadian Imperial Bank of Commerce
Commerce Court
Toronto, Canada M4L 1A2

Dear Mr. Fullerton:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, Canadian Imperial Bank of Commerce, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

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Sincerely,

Howard M. Metzenbaum
Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill Clay
William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Daniel Callahan
Chairman
American Security Bank, N.A.
1501 Pennsylvania Avenue, NW
Washington, D.C. 20013

Dear Mr. Callahan:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, American Security Bank, N.A., as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

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Sincerely,

Howard M. Metzenbaum
Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill
William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

Congress of the United States
Washington, DC 20515

March 11, 1987

Mr. Tamotsu Yamaguchi
Chairman
Bank of Tokyo Trust Company
100 Broadway
New York, NY 10005

Dear Mr. Yamaguchi:

On March 24, 1987, the Senate Labor Subcommittee and the House Subcommittee on Labor Relations will hold a joint Congressional hearing to evaluate the current law's effectiveness in safeguarding America's pensions. Among other issues our hearing will be addressing the disturbing trend of "forced" terminations of healthy pension plans as a consequence of the restructuring of corporations.

In the course of preparing for this hearing, your institution, was identified as a participant in an unusual loan agreement requiring such plan terminations. Last May, Bank of Tokyo Trust Company, as a member of a consortium of nine lenders, completed a loan which aided a merger between Schick Inc. and Reeves Inc. That loan agreement requires the termination of two Reeves employee pension plans and surplus plan assets, up to $20 million, must be given to your bank and others as partial repayment of the loan. The Reeves salaried employees plan is currently in the process of termination and apparently a termination of the Reeves hourly employees plan will soon follow.

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Sincerely,

Howard M. Metzenbaum
Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Senate Committee on Labor
and Human Resources

Bill Clay
William L. Clay
Chairman
Subcommittee on Labor-Management
Relations
Committee on Education and Labor

SCHICK
INCORPORATED
30 GOODWIVES RIVER ROAD, DARIEN CT. 06820

JAMES W. HART, JR.
GROUP VICE PRESIDENT
(203) 655-6855

July 15, 1987

The Honorable William Proxmire, Chairman
Senate Committee on Banking, Housing and Urban Affairs

The Honorable Howard M. Metzenbaum, Chairman
Senate Subcommittee on Labor

The Honorable William L. Clay, Chairman
House Subcommittee on Labor - Management Relations

Congress of the United States
Washington, D.C. 20515

Dear Messrs. Proxmire, Metzenbaum, and Clay:

Subject: Schick Incorporated, Reeves Brothers Inc., and the Amalgamated Clothing Textile Workers Union (ACTWU)

In reference to quotations of Mr. Proxmire from Pensions & Investment Age, March 23 and June 15, 1987, "Mr. Proxmire pointed to a plan by Darien, Conn.-based Schick Co., which recently took over Reeves Brothers Inc., Spartanburg, S.C., to terminate Reeves pension plan and use $25 million in surplus funds to repay debt incurred in the takeover" and "'None defended this plan,' including the company, its bankers and its advisers, Mr. Proxmire noted in remarks in the Congressional Record."

In regard to the above, note the following:

I. Letter (April 3, 1987) from Messrs. Clay and Metzenbaum to James W. Hart

II. Letter (May 5, 1987) from James W. Hart to Messrs. Clay and Metzenbaum (cc: Mr. Proxmire)

III. Drexel Burnham Lambert letter June 17, 1987 and Feder & Associates (counsel for ACTWU) letter May 20, 1987

IV. National Westminster Bank USA letter May 28, 1987 and Feder & Associates (counsel for ACTWU) letter May 21, 1987

V. News Release and Complaint Reeves Brothers, Inc. (Plaintiff) versus ACTWU; Local Union 2500; ACTWU; Robert J. Matkowski; William Steven Knox; and all others acting in concert with them (Defendants)

Sincerely,

James W. Hart, Jr.

Attachments

cc: See Attached

cc: Mr. Malcolm Baldrige
Secretary of Commerce

Mr. William E. Brock
Secretary of Labor

Mr. Edwin Meese, III
Attorney General

SUBCOMMITTEE ON LABOR - MANAGEMENT RELATIONS

The Honorable Richard Armey
The Honorable Cass Ballenger
The Honorable Mario Biaggi
The Honorable Harris W. Fawell
The Honorable William D. Ford
The Honorable Charles A. Hayes
The Honorable Jim Jontz
The Honorable Dale E. Kildee
The Honorable Austin J. Murphy
The Honorable Major R. Owens
The Honorable Thomas E. Petri
The Honorable Marge Roukema
The Honorable Thomas C. Sawyer

SUBCOMMITTEE ON LABOR

The Honorable Tom Harkin
The Honorable Gordon J. Humphrey
The Honorable Spark M. Matsunaga
The Honorable Barbara A. Mikulski
The Honorable Dan Quayle
The Honorable Robert T. Stafford

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

The Honorable William L. Armstrong
The Honorable Christopher S. Bond
The Honorable Alan Carnston
The Honorable John H. Chafee
The Honorable Alfonse M. D'Amato
The Honorable Alan J. Dixon
The Honorable Christopher J. Dodd
The Honorable Jake Garn
The Honorable Bob Graham
The Honorable Phil Gramm
The Honorable Chick Hecht
The Honorable John Heinz
The Honorable Donald W. Riegle
The Honorable Terry Sanford
The Honorable Paul S. Sarbanes
The Honorable Jim Sasser
The Honorable Richard C. Shelby

EXHIBIT I.

Congress of the United States
Washington, DC 20515

April 3, 1987

RECEIVED
APR 15 1987
J W HART

Mr. James W. Hart
Chairman
Schick, Inc.
30 Goodwives River Road
Darien, CT 06820

Dear Mr. Hart:

This past Tuesday, March 24th, an employee of Schick, Mr. Steve Knox, testified at a joint hearing held before our Subcommittees on the subject of pension terminations. His testimony was both moving and distressing. We have been following the issue of the Schick/Reeves Brothers termination closely and are deeply concerned about its immediate and long term implications.

It is our understanding that the surplus assets of two pension plans, up to $20 million, are to be used to pay off bank debts incurred during your purchase of Reeves. To our knowledge, your case is the first in which an agreement to utilize surplus pension fund assets is signed as part of a friendly merger in which both parties are on solid financial footing. We are concerned that this practice will become more widespread and terminations will, therefore, become more common.

I have enclosed a copy of Mr. Knox's testimony before our Subcommittees. Before we develop legislation that will affect how and whether pension fund terminations might be limited, we wanted to offer you a chance to present your views.

We would appreciate any written comments you may have.

Sincerely,

Bill
Howard M. Metzenbaum

William L. Clay Chairman House Subcommittee on Labor-Management Relations	Howard M. Metzenbaum Chairman Senate Subcommittee on Labor

Enclosure

Testimony of Steve Knox, an employee of Reeves Brothers, Inc. and a member of the Amalgamated Clothing and Textile Workers Union Local 2500 before the Senate Subcommittee on Labor and the House Subcommitte on Labor Management Relations at the Joint Oversight Hearing on Overfunded and Underfunded Pension Plans

March 24, 1987

My name is Steve Knox and I work for Reeves Brothers Inc. in Cornelius, North Carolina. I am thirty-one years old and have worked at Reeves for twelve years. I am married and am a father of four children.

I am speaking to you today officially as a representative of my 750 brother and sister union members of the Amalgamated Clothing and Textile Workers Union at the two Cornelius plants of Reeves Brothers. But I also feel that I am representing all 7,000 Reeves employees throughout the United States. I am honored to be speaking to such a distinguished panel about the concerns of these good Americans.

In April of 1986 my fellow workers in Cornelius and I voted to join the Amalgamated Clothing and Textile Workers Union in an election conducted by the National Labor Relations Board. In May of that same year our company was sold to Schick, Inc. of Darien, Connecticut. Part of the agreement that allowed Schick to buy Reeves included a one hundred million dollar loan from nine banks. National Westminster Bank, USA was the lead bank and the entire buy-out was organized by Drexel Burnham Lambert which is, as I'm sure you are aware, currently under government investigation.

We believed that nothing really was changed by this buy-out; but we were wrong. The loan agreement has a clause in it where Schick and Reeves have agreed to terminate our pensions and give any surplus funding to the banks. We feel this is very unfair. We believe that the pension surplus belongs to all of the workers of Reeves Brothers, whose hard work created the company's ability to make contributions in the first place. You may say to yourselves what is the big deal? The Reeves employees will still have a pension and the excess money will rescue a company in desperate financial shape--but your assumptions would be wrong. Reeves and Schick are very healthy companies that have had excellent profits over the years. This termination, if allowed, represents the banks and our company getting together to steal our retirement security, at great cost to us but of little benefit to big multi-million and billion dollar banks. Today the average retirement benefit for hourly employees is only $61. No person could possibly live on this amount. But I feel the issue goes beyond just the relationship between some banks and our company.

When I came to Reeves brothers a long time ago I read in our pension booklet that the pension plan was set up for us, the workers at Reeves. We were told and we believed that as the pension fund grew larger we would benefit from this growth when we retired. We thought we would get more money, we never thought that the extra cushion would be used to pay off any debts but our own! Now our pension plan is about to be raided. Our hard earned money is being taken away from us. Not because the company will go bankrupt if it doesn't get it, but just because it wants the money which happens to be handy. We turn to you our representatives, for justice. We really need your help. Times are hard for a lot of people in this country right now. We expect that our retirements may also be hard. But you can help us by stopping the type of abuses that I have just described. Thank you for your help.

EXHIBIT II.

SCHICK
INCORPORATED
30 GOODWIVES RIVER ROAD, DARIEN, CT. 06820

JAMES W HART
CHAIRMAN AND PRESIDENT

May 5, 1987

The Honorable Howard M. Metzenbaum
Chairman
Senate Subcommittee on Labor

The Honorable William L. Clay
Chairman
House Subcommittee on Labor-
Management Relations
Congress of the United States
Washington, D.C. 20515

Dear Senator Metzenbaum and Represenative Clay:

Pursuant to your letter of April 3, 1987 (attached):

> Reeves Brothers, Inc., a subsidiary of Schick Incorporated, and certain Reeves' employees, members of the Amalgamated Clothing and Textile Workers' Union, are negotiating a contract consistent with the requirements of the collective bargaining process.
>
> The Reeves' Pension Plan is fully funded. It meets all actuarial and legal standards. The participants' rights are totally protected.

The existence of the Reeves' Pension Plan is the result of a professional management which has conducted the affairs of the company for over 40 years on an uninterrupted profitable basis. The surplus in the Pension Plan is a product of the management's stewardship. The many underfunded pension plans throughout the private sector provide a comparative measure.

The Honorable Howard M. Metzenbaum
The Honorable William L. Clay
May 5, 1987
Page 2

The management of Reeves made a commitment to provide specific dollar benefits to each employee. It has fulfilled this obligation. If the performance of the company facilitates the assumption of additional obligations, those obligations will also be fulfilled.

Sincerely,

James W. Hart

James W. Hart

JWH:rap

Attachment

cc: The Honorable Christopher Bond
The Honorable John H. Chafee
The Honorable Alfonse M. D'Amato
The Honorable Jake Garn
The Honorable Robert Graham
The Honorable John Heinz
The Honorable William Proxmire
The Honorable Donald Riegle, Jr.
The Honorable Terry Sanford
The Honorable Richard Shelby

EXHIBIT III.

Drexel Burnham Lambert

Drexel Burnham Lambert Incorporated
60 Broad Street
New York, NY 10004-2367
212 480-6000

June 17, 1987

David R. Levin, Esq.
Feder & Associates
1527 18th Street, N.W.
Washington, D.C. 20036

Dear Mr. Levin:

Your letter of May 20, 1987 to Mr. Frederick H. Joseph has been referred to me.

I refer you to Mr. Joseph's March 23, 1987 letter to Senator Metzenbaum, a copy of which you have. I do not believe that any further reply to your letter is necessary or desirable, except to say that Drexel Burnham Lambert Incorporated does not accept the allegations of fact or conclusions of law set forth in your letter, rejects any implication or accusation of wrongful conduct on its part and categorically disclaims any obligation or liability on its part to your client or any third party in connection with any of the matters referred to in your letter.

Very truly yours,

Stanley Moss

Stanley J. Moss
Senior Vice President
and Corporate Counsel

SJM:dm

FEDER & ASSOCIATES
ATTORNEYS AT LAW
1527 18TH STREET, N. W.
WASHINGTON, D. C. 20036

Gerald M. Feder
David R. Levin
Timothy St. Clair Smith
Louis P. Malone III
Linda Kragie†
† admitted in Illinois only

202 387-1515

May 20, 1987

FEDERAL EXPRESS

Frederick H. Joseph
Chief Executive Officer
Vice Chairman of the Board
Drexel Burnham Lambert Incorporated
60 Broad Street
New York, New York 10004-2367

Re: Reeves Brothers, Inc./Newreeveco, Inc.

Dear Mr. Joseph:

This firm is special counsel to the Amalgamated Clothing & Textile Workers Union (the "ACTWU"). I am writing to you concerning your company's involvement in the use of assets from the Reeves Brothers, Inc. Pension Trust to accomplish a take-over of Reeves Brothers, Inc./ Newreevco, Inc. ("Reeves") by Schick Incorporated. I have a number of questions, to which I would appreciate your response. To put those questions in context, I believe that a review of certain facts is appropriate.

In 1962 Reeves established the Reeves Brothers, Inc. Pension Trust (the "Trust"). The express purpose for establishing the Trust was to provide retirement income to Reeves' salaried employees. Consequently, in addition to establishing the Trust, Reeves adopted "The Reeves Brothers, Inc. Pension Plan." The South Carolina National Bank was made the trustee of the Trust assets.

As established in 1962, the Trust provided:

> The initial contribution and all future contributions made by the Company and/or its subsidiaries hereunder shall be

> irrevocable and no part of the principal or income of the trust shall revert to the Company or any of its subsidiaries or be used for or diverted to purposes other than for the exclusive benefit of the present and future employees (or their beneficiaries) of the Company and its subsidiaries which adopt the plan.

1962 Trust at § 2.2 (emphasis added).

Consistent with this prohibition against the reversion of Trust assets to Reeves, the trustee South Carolina National Bank was expressly forbidden from permitting Trust assets to be paid to Reeves:

> The Trustee shall make such distributions out of the fund of the trust at such time or times as to such person or persons and in such amounts as the Pension Committee shall direct in writing. In directing the Trustee to make payments in cash or in kind out of either fund, the Committee shall follow the provisions of the plan and in no event may the Committee direct that any payment be made either during the existence or upon the discontinuance of the plan which would cause any part of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants of the plan and their beneficiaries.

1962 Trust at § 7.1.

In order to ensure the irrevocability of this prohibition against the reversion of assets to Reeves, the Trust expressly precluded Reeves from amending the Trust, if such amendment were to result in a use of assets other than for the benefit of the employees covered by the plan and their beneficiaries:

> The Company may at any time alter, modify, or amend, in whole or in part, any or all of the provisions of this trust agreement, provided that no such alteration, modification or amendment may

> permit any part of the principal or income of the trust to be used for or diverted to purposes other than for the exclusive benefit of the employees covered by the plan and their beneficiaries, and provided further, that no such alteration, modification or amendment which affects the rights, duties or responsibilities of the Trustee may be made without its consent.

1962 Trust § 13.1.

Consistent with the Trust provisions denying Reeves access to the Trust assets, the "Reeves Brothers, Inc. Pension Plan" stated:

> The Company intends to continue the Plan described herein as a permanent program. However, the Company specifically reserves the right, by resolution of its Board of Directors, to amend, suspend or terminate the Pension Plan described herein at any time and for any reason, except that no amendment, suspension or termination of the Plan shall affect adversely pensions previously granted to retired or disabled employees, and provided further that no amendment, suspension or termination of the Plan may be made which would permit any part of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants of the Plan and their beneficiaries.

Plan § 12.1.

Moreover, the distribution of Trust assets, in the event of termination, was set forth in detail and expressly prohibited the payment of any assets to Reeves:

> In the event of the final termination of the Plan, the Pension Committee shall instruct the Trustee to apply the pension funds in the following order of priority:

> (1) All expenses of the trust shall be paid.
>
> (2) The funds necessary to provide pensions for employees who have retired and who have been awarded a pension shall be segregated and earmarked for such purpose, or such pensions shall be provided through the purchase of annuity contracts.
>
> (3) All remaining funds shall be held for the benefit of those employees who have not yet met the age, service and other requirements essential for a pension. Such funds shall be distributed to such employees in an equitable and non-discriminatory manner consistent with accepted actuarial practices pursuant to instructions from the Pension Committee and at the time and in the manner directed by the Pension Committee.
>
> (4) No funds shall revert to the Company.

Plan § 12.2.

The Trust document and Plan document were amended from time to time.[1/] So, for example, after the enactment of the Employee Retirement Income Security Act ("ERISA") in 1974, the Plan document was revised to provide at section 8.2 that upon termination, the Trust assets "shall be allocated among the Participants and their joint annutants and beneficiaries in accordance with section 4044(a)" of ERISA, 29 U.S.C. § 1344(a). That particular statutory subsection provides for distribution of Trust assets only to participants and beneficiaries -- not to their employer:

[1/] For example, in 1971, Reeves amended the Trust to, permit the use of Trust assets to pay benefits to Reeves hourly employees. Therefore, at that time, Reeves also adopted "The Reeves Brothers, Inc. Pension Plan for Hourly Employees," which sets forth, *inter alia*, benefit provisions for the hourly employees.

Moreover, the Plan document continued to provide that no amendment shall be made which would make it possible for Trust assets "to be used for or diverted to purposes other than for the exclusive benefit of the Participants and their joint annuitants or beneficiaries." Plan § 8.1.

In May of 1986, Schick Incorporated acquired Reeves. You have stated that Drexel Burnham Lambert ("Drexel") acted as "financial advisor to Schick Incorporated in connection with the acquisition," and that Drexel "helped arrange the bank financing."[2] The terms of the bank financing, which are set forth in a loan agreement dated as of May 1, 1986, provide that Reeves Brothers is to use Trust assets to make loan prepayments in an amount not to exceed $20 million. Loan Agreement at § 1.9(b)(ii).

The Chairman of the Board of Sovran Financial Corporation alleges that "[t]he terms of this financing proposal were presented to Sovran by Schick and its financial advisor," i.e., Drexel.[3] The President of Reeves, who is one of the trustees of the Trust assets, alleges that "when Reeves Brothers, Inc. became a subsidiary of Schick last May, one of the conditions of the transaction was that Reeves Brothers, Inc. had to use the excess funds in the Plan to help pay off the loans."[4]

However, the Trust and Plan documents prohibited Reeves' use of Trust assets. So, on June 18, 1986 -- a month and a half after the take-over -- Plan section 8.2 was amended, effective "immediately", ostensibly to provide that after benefits are paid "any residual assets in the [Trust] Fund shall be distributed to the Employer." Then on October 1, 1986, the Trust document was amended ostensibly to allow for the reversion of Trust assets to Reeves. See Trust §§ 2.5, 6.1, 7.4, and 7.6.

---

[2] March 23, 1987 letter to the Honorable Howard Metzenbaum from F.H. Joseph at 1.

[3] March 23, 1987 letter to the Honorable Howard Metzenbaum from C.A. Cutchins, III.

[4] September 26, 1986 form letter to "Salaried Pension Plan Participant" from J.E. Reeves, Jr.

Before proceeding, I direct your attention to the fact that the federal judiciary holds that -- where there is an initial prohibition against reversion and against plan or trust amendments that would cause assets to be used other than for the exclusive benefit of participants -- subsequent amendments permitting a reversion are void. See, e.g., Bryant v. International Fruit Products Co., Inc., 793 F.2d 118 (6th Cir. 1986); Pension Benefit Guaranty Corporation v. Audio Fidelity Corp., 624 F.2d 513 (4th Cir. 1980).

An impermissible attempt to amend a distribution provision itself constitutes a breach of a fiduciary duty under ERISA. Delgrosso v. Spang & Co., 769 F.2d 928 (3d Cir. 1985). Moreover, the impermissible use of Trust assets for the benefit of the employer is a prohibited transaction under ERISA. 29 U.S.C. §§ 1106(a), 1106(b). "Similarly, the transfer of plan assets to [the Bank] in exchange for the bank's agreement to finance [the] acquisition of the companies violates ERISA standards. Freund v. Marshall & Ilsley Bank, 485 F. Supp. 629 (W.D. Wis. 1979)." Wright v. Nimmons, 641 F. Supp. 1391, 1403 (S.D. Tex. 1986).

The Department of Labor and the federal judiciary hold that non-fiduciaries are liable under ERISA for knowingly participating in a breach of trust, without regard to whether the participation was direct or indirect. Brock v. Gerace, 635 F. Supp. 563 (D.N.J. 1986).[5]

The liability of one participating in a fiduciary breach is joint and several with the breaching fiduciary.

---

[5]

> "[A] defendant who is not in the class of persons to whom a substantive statute is directed may still be guilty of aiding and abetting for causing, inducing, or procuring the statutory violation."

United States v. Odom, 736 F.2d 150, 152 (5th Cir. 1984). See United States v. Santiago, 528 F.2d 1130 (2d Cir. 1976) (conversion of funds from an employee benefit fund cannot be condoned simply because it may have been accomplished by indirect means); 18 U.S.C. § 664. Black's Law Dictionary simply states that "one who aids and abets another in keeping property from its rightful owner is guilty of conversion."

Fremont v. McGraw Edison, 606 F.2d 752, 759 (7th Cir. 1979), cert. denied, 445 U.S. 951 (1980). "[T]he receipt of trust assets by a third party resulting from a fiduciary breach constitutes sufficient participation for purposes of establishing knowing participation." Donovan v. Schmoutey, 592 F. Supp. 1361, 1396 (D. Nev. 1984) (citations deleted). See Restatement (Second) of Trusts §§ 291, 295, 296, 297.

"The law requires of those dealing with a trustee the exercise of good faith toward the beneficiaries of the trust . . . [P]ersons knowingly dealing with trustees are under a duty of inquiry . . ." Donovan v. Schmoutey, 592 F. Supp. at 1396 (citation deleted). Accord Bigger v. American Commercial Lines, Inc., 652 F. Supp. 123, 127 (W.D. Mo. 1986).6/

In light of the foregoing, I now pose my questions to you:

(1) What steps did Drexel take to learn the terms of the documents and instruments governing the use and disposition of Trust assets? Who took these steps and when?

(2) When did Drexel first learn that the Plan document and Trust document prohibited the use of Trust assets by Reeves and only permitted the use of Trust assets for the benefit of participants and beneficiaries? Who at Drexel learned this?

(3) What role did Drexel play in making the use of Trust assets an element in the Schick acquisition? Who at Drexel was involved in this aspect of the acquisition? Who drafted Loan Agreement section 1.9(b)(ii)?

6/ The Bigger court held that an allocation of assets to a spun-off plan was to be made in accordance with ERISA's fiduciary standards and that the actuary, who performs the allocation, is a fiduciary. "The court does not see how any important decision regarding a plan's assets, especially if made in the interest of someone other than plan participants . . . could be exempted from this comprehensive [ERISA] standard. Cf. Leigh v. Engle, 727 F.2d 113, 124 (7th Cir. 1984)." 652 F. Supp. at 127.

(4) Who prepared the amendments to the Trust document and Plan document to permit ostensibly the reversion of Trust assets to Reeves?

(5) Who at Reeves informed you "that this type of pension plan reversion is fully in compliance with the law"?[7]

(6) What communications did Drexel have with the Wyatt Company generally and with Nathan B. Borden in particular, concerning the Trust assets? Who at Drexel had these communications and when?

(7) Who at Drexel first learned that the Pension Committee, and not Reeves, is the plan administrator? When did Drexel first make this discovery?

(8) Who, other than participants and beneficiaries, have received Trust assets since March 15, 1987? Who made these payments? What role did Drexel play in connection with the making of these payments? When were these payments made?

(9) Does Drexel know whether any of the money it received for its role in the acquisition was paid directly or indirectly with Trust assets? How much was Drexel paid and when? What is the relationship between the amount Drexel was paid and the amount of bank financing that was obtained?

(10) What steps has Drexel taken and what steps does Drexel plan to take to return to the Trust those assets which have been used other than for the benefit of participants? When were these steps taken? When does Drexel plan to take further steps?

(11) What steps did Drexel take to assure itself of the availability of monies to prepay the "Term Loans" under the Loan Agreement? When did Drexel take these steps? In what way did Drexel's steps to assure the availability of Trust assets to make prepayments differ from the steps

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7/ This quotation is from page 2 of your March 23, 1987 letter to Senator Metzenbaum.

Drexel took to assure itself of the availability of monies to make any other prepayments under the Loan Agreement?

I would appreciate your responses no later than May 29, 1987. If you have any questions regarding these matters, please do not hesitate to call.

Sincerely,
Feder & Associates

By David R. Levin
Gerald M. Feder
David R. Levin

cc: Nathan B. Borden
The Wyatt Company

South Carolina National Bank

csn:051987L1

EXHIBIT IV.

National Westminster Bank USA

175 Water Street
New York, NY 10038
212 602 1505

George B. Berridge
Senior Vice President
and General Counsel

May 28, 1987

Gerald M. Feder, Esq.
David R. Levin, Esq.
Feder & Associates
1527 18th Street, N.W.
Washington, D.C. 20036

Dear Sirs:

Your letter of May 21, 1987 to William T. Knowles has been referred to me.

Based upon a review of the circumstances relating to the transaction in question, including advice from outside counsel, I have concluded that no actions taken by National Westminster Bank USA have been either unlawful or improper. Accordingly, in my opinion, no useful purpose would be served by responding to the questions raised in your letter.

Very truly yours,

George B Berridge

George B. Berridge

GBB/ks

FEDER & ASSOCIATES

ATTORNEYS AT LAW
1527 18TH STREET, N. W.
WASHINGTON, D. C. 20036

Gerald M. Feder
David R. Levin
Timothy St. Clair Smith
Louis P. Malone III
Linda Kragie*
* admitted in Illinois only

202 387-1515

May 21, 1987

FEDERAL EXPRESS

William T. Knowles
Chairman of the Board
Chief Executive Officer
National Westminster Bank USA
175 Water Street
New York, New York 10038

Re: Reeves Brothers, Inc./Newreeveco, Inc.

Dear Mr. Knowles:

This firm is special counsel to the Amalgamated Clothing & Textile Workers Union (the "ACTWU"). I am writing to you concerning the involvement of National Westminster Bank USA ("National") in the use of assets from the Reeves Brothers, Inc. Pension Trust to accomplish a take-over of Reeves Brothers, Inc./Newreevco, Inc. ("Reeves") by Schick Incorporated. I have a number of questions, to which I would appreciate your response. To put those questions in context, I believe that a review of certain facts is appropriate.

In 1962 Reeves established the Reeves Brothers, Inc. Pension Trust (the "Trust"). The express purpose for establishing the Trust was to provide retirement income to Reeves' salaried employees. Consequently, in addition to establishing the Trust, Reeves adopted "The Reeves Brothers, Inc. Pension Plan." The South Carolina National Bank was made the trustee of the Trust assets.

As established in 1962, the Trust provided:

> The initial contribution and all future contributions made by the Company and/or

> its subsidiaries hereunder shall be irrevocable and no part of the principal or income of the trust shall revert to the Company or any of its subsidiaries or be used for or diverted to purposes other than for the exclusive benefit of the present and future employees (or their beneficiaries) of the Company and its subsidiaries which adopt the plan.

1962 Trust at § 2.2 (emphasis added).

Consistent with this prohibition against the reversion of Trust assets to Reeves, the trustee South Carolina National Bank was expressly forbidden from permitting Trust assets to be paid to Reeves:

> The Trustee shall make such distributions out of the fund of the trust at such time or times as to such person or persons and in such amounts as the Pension Committee shall direct in writing. In directing the Trustee to make payments in cash or in kind out of either fund, the Committee shall follow the provisions of the plan and in no event may the Committee direct that any payment be made either during the existence or upon the discontinuance of the plan which would cause any part of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants of the plan and their beneficiaries.

1962 Trust at § 7.1.

In order to ensure the irrevocability of this prohibition against the reversion of assets to Reeves, the Trust expressly precluded Reeves from amending the Trust, if such amendment were to result in a use of assets other than for the benefit of the employees covered by the plan and their beneficiaries:

> The Company may at any time alter, modify, or amend, in whole or in part, any or all of the provisions of this trust agreement, provided that no such

> alteration, modification or amendment may permit any part of the principal or income of the trust to be used for or diverted to purposes other than for the exclusive benefit of the employees covered by the plan and their beneficiaries, and provided further, that no such alteration, modification or amendment which affects the rights, duties or responsibilities of the Trustee may be made without its consent.

1962 Trust § 13.1.

Consistent with the Trust provisions denying Reeves access to the Trust assets, the "Reeves Brothers, Inc. Pension Plan" stated:

> The Company intends to continue the Plan described herein as a permanent program. However, the Company specifically reserves the right, by resolution of its Board of Directors, to amend, suspend or terminate the Pension Plan described herein at any time and for any reason, except that no amendment, suspension or termination of the Plan shall affect adversely pensions previously granted to retired or disabled employees, and provided further that no amendment, suspension or termination of the Plan may be made which would permit any part of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants of the Plan and their beneficiaries.

Plan § 12.1.

Moreover, the distribution of Trust assets, in the event of termination, was set forth in detail and expressly prohibited the payment of any assets to Reeves:

> In the event of the final termination of the Plan, the Pension Committee shall instruct the Trustee to apply the pension funds in the following order of priority:

> (1) All expenses of the trust shall be paid.
>
> (2) The funds necessary to provide pensions for employees who have retired and who have been awarded a pension shall be segregated and earmarked for such purpose, or such pensions shall be provided through the purchase of annuity contracts.
>
> (3) All remaining funds shall be held for the benefit of those employees who have not yet met the age, service and other requirements essential for a pension. Such funds shall be distributed to such employees in an equitable and non-discriminatory manner consistent with accepted actuarial practices pursuant to instructions from the Pension Committee and at the time and in the manner directed by the Pension Committee.
>
> (4) No funds shall revert to the Company.

Plan § 12.2.

The Trust document and Plan document were amended from time to time.[1] So, for example, after the enactment of the Employee Retirement Income Security Act ("ERISA") in 1974, the Plan document was revised to provide at section 8.2 that upon termination, the Trust assets "shall be allocated among the Participants and their joint annutants and beneficiaries in accordance with section 4044(a)" of ERISA, 29 U.S.C. § 1344(a). That particular statutory subsection provides for distribution of Trust assets only to participants and beneficiaries -- not to their employer. Moreover, the Plan document continued to provide that no amendment shall be made which would make it possible for Trust assets "to be used for or diverted to purposes other than for the exclusive benefit of the Participants and their joint annuitants or beneficiaries." Plan § 8.1.

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[1] For example, in 1971, Reeves amended the Trust to permit the use of Trust assets to pay benefits to Reeves' hourly employees. Therefore, at that time, Reeves also adopted "The Reeves Brothers, Inc. Pension Plan for Hourly Employees," which sets forth, *inter alia*, benefit provisions for the hourly employees.

In May of 1986, Schick Incorporated acquired Reeves. The terms of the bank financing, which are set forth in a loan agreement dated as of May 1, 1986, provide that Reeves Brothers is to use Trust assets to make loan prepayments in an amount not to exceed $20 million. Loan Agreement at § 1.9(b)(ii).

The President of Reeves, who is one of the trustees of the Trust assets, alleges that "when Reeves Brothers, Inc. became a subsidiary of Schick last May, one of the conditions of the transaction was that Reeves Brothers, Inc. had to use the excess funds in the Plan to help pay off the loans."2/

You allege that "this transaction was handled in a manner entirely consistent with [National's] policy . . ."3/ However, the Trust and Plan documents prohibited Reeves' use of Trust assets. So, on June 18, 1986 -- a month and a half after the take-over -- Plan section 8.2 was amended, effective "immediately", ostensibly to provide that after benefits are paid "any residual assets in the [Trust] Fund shall be distributed to the Employer." Then on October 1, 1986, the Trust document was amended ostensibly to allow for the reversion of Trust assets to Reeves. See Trust §§ 2.5, 6.1, 7.4, and 7.6.

Before proceeding, I direct your attention to the fact that the federal judiciary holds that -- where there is an initial prohibition against reversion and against plan or trust amendments that would cause assets to be used other than for the exclusive benefit of participants -- subsequent amendments permitting a reversion are void. See, e.g., Bryant v. International Fruit Products Co., Inc., 793 F.2d

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2/ September 26, 1986 form letter to "Salaried Pension Plan Participant" from J.E. Reeves, Jr.

3/ March 19, 1987 letter to the Honorable Howard Metzenbaum and the Honorable William L. Clay from W.T. Knowles.

113 (6th Cir. 1986); *Pension Benefit Guaranty Corporation v. Audio Fidelity Corp.*, 624 F.2d 513 (4th Cir. 1980).

An impermissible attempt to amend a distribution provision itself constitutes a breach of a fiduciary duty under ERISA. *Delgrosso v. Spang & Co.*, 769 F.2d 928 (3d Cir. 1985). Moreover, the impermissible use of Trust assets for the benefit of the employer is a prohibited transaction under ERISA. 29 U.S.C. §§ 1106(a), 1106(b). "Similarly, the transfer of plan assets to [the Bank] in exchange for the bank's agreement to finance [the] acquisition of the companies violates ERISA standards. *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629 (W.D. Wis. 1979)." *Wright v. Nimmons*, 641 F. Supp. 1391, 1403 (S.D. Tex. 1986).

The Department of Labor and the federal judiciary hold that non-fiduciaries are liable under ERISA for knowingly participating in a breach of trust, without regard to whether the participation was direct or indirect. *Brock v. Gerace*, 635 F. Supp. 563 (D.N.J. 1986).[4]

The liability of one participating in a fiduciary breach is joint and several with the breaching fiduciary. *Fremont v. McGraw Edison*, 606 F.2d 752, 759 (7th Cir. 1979), *cert. denied*, 445 U.S. 951 (1980). "[T]he receipt of trust assets by a third party resulting from a fiduciary breach constitutes sufficient participation for purposes of establishing knowing participation." *Donovan v. Schmoutey*, 592 F. Supp. 1361, 1396 (D. Nev. 1984) (citations deleted). *See Restatement (Second) of Trusts* §§ 291, 295, 296, 297.

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[4] "[A] defendant who is not in the class of persons to whom a substantive statute is directed may still be guilty of aiding and abetting for causing, inducing, or procuring the statutory violation."

United States v. Odom, 736 F.2d 150, 152 (5th Cir. 1984). *See United States v. Santiago*, 528 F.2d 1130 (2d Cir. 1976) (conversion of funds from an employee benefit fund cannot be condoned simply because it may have been accomplished by indirect means); 18 U.S.C. § 664. Black's Law Dictionary simply states that "one who aids and abets another in keeping property from its rightful owner is guilty of conversion."

"The law requires of those dealing with a trustee the exercise of good faith toward the beneficiaries of the trust . . . [P]ersons knowingly dealing with trustees are under a duty of inquiry . . ." *Donovan v. Schmoutey*, 592 F. Supp. at 1396 (citation deleted). *Accord Bigger v. American Commercial Lines, Inc.*, 652 F. Supp. 123, 127 (W.D. Mo. 1986).[5]

In light of the foregoing, I now pose my questions to you:

(1) What steps did National take to learn the terms of the documents and instruments governing the use and disposition of Trust assets? Who took these steps and when?

(2) When did National first learn that the Plan document and Trust document prohibited the use of Trust assets by Reeves and only permitted the use of Trust assets for the benefit of participants and beneficiaries? Who at National learned this?

(3) What role did National play in making the use of Trust assets an element in the Schick acquisition? Who at National was involved in this aspect of the acquisition? Who drafted Loan Agreement section 1.9(b)(ii)? Which agents or representatives of National reviewed or otherwise participated in the preparation of the Loan Agreement? Over what period of time did this review or other participation in the preparation of the Loan Agreement take place?

(4) Who prepared the amendments to the Trust document and Plan document to permit ostensibly the reversion of Trust assets to Reeves?

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[5] The *Bigger* court held that an allocation of assets to a spun-off plan was to be made in accordance with ERISA's fiduciary standards and that the actuary, who performs the allocation, is a fiduciary. "The court does not see how any important decision regarding a plan's assets, especially if made in the interest of someone other than plan participants . . . could be exempted from this comprehensive [ERISA] standard. *Cf. Leigh v. Engle*, 727 F.2d 113, 124 (7th Cir. 1984)." 652 F. Supp. at 127.

(5) How many times has National participated in a financial arrangement, where there was a provision like Loan Agreement Section 1.9(b)(ii), in light of your statement that "it is customary and consistent with common lending practices" to include such a provision?[6]

(6) What communications did National have with the Wyatt Company generally and with Nathan B. Borden in particular, concerning the Trust assets? Who at National had these communications and when?

(7) Who at National first learned that the Pension Committee, and not Reeves, is the plan administrator? When did National first make this discovery?

(8) Who, other than participants and beneficiaries, have received Trust assets since March 15, 1987? Who made these payments? What role did National play in connection with the making of these payments? When were these payments made?

(9) Does National know whether any of the money it received for its role in the acquisition was paid directly or indirectly with Trust assets? How much was National paid and when?

(10) What steps has National taken and what steps does National plan to take to return to the Trust those assets which have been used other than for the benefit of participants? When were these steps taken? When does National plan to take further steps?

(11) What steps did National take to assure itself of the availability of monies to prepay the "Term Loans" under the Loan Agreement? When did National take these steps? In what way did National's steps to assure the availability of Trust assets to make prepayments differ from the steps Drexel took to assure itself of the availability of monies to make any other prepayments under the Loan Agreement?

6/ This quotation is from your March 19, 1987 letter to Senator Metzenbaum.

(12) After National received the March 11, 1987 inquiry from Senator Metzenbaum and Congressman Clay, what steps did you take to permit you to "assure [Messrs. Metzenbaum and Clay] that this transaction was handled in a manner entirely consistent with our policy . . ."[7]

I would appreciate your responses no later than May 29, 1987. If you have any questions regarding these matters, please do not hesitate to call.

Sincerely,
Feder & Associates

By David R. Levin
Gerald M. Feder
David R. Levin

csn:051987Llc

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[7] This quotation is from your March 19, 1987 letter to Senator Metzenbaum.

SENT BY:C.W.&T 100 MAIDEN LN. ; 7- 1-87 ;10:52AM ; 10000449150400000→ 10000449120305050667;# 2

EXHIBIT V.

REEVES

REEVES BROTHERS, INC.

P. O. Box 1898, Spartanburg, South Carolina 29304 · Telephone (803) 576-1210

Max E. Justice, Esquire
Parker, Poe, et al
(704) 372-9000

DATE: June 18, 1987

PRESS RELEASE

Reeves Sues ACTWU For Sabotage

Reeves Brothers, Inc. today filed suit against the Amalgamated Clothing and Textile Workers Union (AFL-CIO), Local 2500 of the ACTWU, Robert Matkowski, an ACTWU employee, and William Steven Knox, a local member of the ACTWU, in the North Carolina Superior Court in Charlotte, North Carolina. The Suit alleges that the ACTWU and the other defendants have conspired to and have engaged in numerous acts of sabotage, property destruction, intimidation of Reeves' employees, and other illegal actions at Reeves' plants located in Cornelius over the past eight months designed to cause serious damage to Reeves' business, property and reputation as well as substantial injury to its employees. The Complaint is based on oral, written and physical evidence obtained by the Company. Reeves, through independent analysis, has determined that if certain of the planned sabotage had not been discovered and stopped it would have caused substantial damage to vital plant equipment requiring complete shutdown of both Cornelius plants for a lengthy period of time and the loss of substantial jobs and business to the area. Reeves has contacted appropriate authorities concerning the defendants' actions.

Reeves' Complaint also states that one of the Cornelius plants has suffered two fires of a suspicious origin. The Mecklenburg County Police are investigating the fires and have offered a reward for information leading to the arrest and conviction of anyone responsible for the fires.

In its Complaint, Reeves is seeking an injunction, and compensatory and punitive damages from the defendants.

STATE OF NORTH CAROLINA

COUNTY OF MECKLENBURG

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
87 CVS 9185

REEVES BROTHERS, INC.,
Plaintiff,

v.

AMALGAMATED CLOTHING AND TEXTILE WORKERS UNION; LOCAL UNION 2500, AMALGAMATED CLOTHING AND TEXTILE WORKERS UNION; ROBERT J. MATKOWSKI; WILLIAM STEVEN KNOX; and all others acting in concert with them,
Defendants.

COMPLAINT

Plaintiff, Reeves Brothers, Inc., complaining of the defendants, says and alleges:

PARTIES

1. Plaintiff Reeves Brothers, Inc. ("Reeves") is a Delaware corporation which, among other businesses, has a Curon Group which operates two polyurethane foam manufacturing plants in Cornelius, Mecklenburg County, North Carolina (the "Cornelius Plants"). The headquarters of the Curon Group is located in Mecklenburg County.

2. Defendant Amalgamated Clothing and Textile Workers Union ("ACTWU") is an unincorporated association. Its national headquarters is in New York City, and it does business in North Carolina through "locals" in Mooresville and other locations in North Carolina. ACTWU has been certified since April, 1986 as

the collective bargaining representative of about 650 Reeves employees in the Cornelius Plants. Representatives of ACTWU conduct business on behalf of ACTWU in Mecklenburg County.

3. Reeves is informed and believes that defendant Local Union 2500, Amalgamated Clothing and Textile Workers Union ("Local 2500") is an unincorporated association chartered by defendant ACTWU. Local 2500 maintains an office in Mooresville, North Carolina, and its representatives conduct business on behalf of Local 2500 in Mecklenburg County.

4. Defendant Robert J. Matkowski is an employee of the defendant ACTWU, who has a residence in Iredell County, North Carolina, and who conducts activities on behalf of ACTWU in Mecklenburg County.

5. Defendant William Steven Knox is a member of ACTWU, resides in Mecklenburg County and is employed by Reeves at one of its Cornelius Plants.

FACTS

6. Plaintiff brings this action seeking a judgment from this Court that the defendants be enjoined preliminarily and permanently from engaging and conspiring to engage in violence, sabotage, trespass and other acts intended to damage property, intimidate employees, disrupt operations at the Cornelius Plants and interfere with the contractual and other economic relations between Reeves and its customers; and that the

defendants pay the plaintiff for all damages caused by the defendants' actions as well as punitive and treble damages because of the willful and malicious nature of the defendants' acts, and attorneys' fees.

7. At all relevant times, Reeves has been attempting to negotiate with ACTWU in an attempt to reach a collective bargaining agreement covering the workers in the Cornelius Plants.

8. Reeves is informed and believes that since the Fall of 1986, ACTWU, Local 2500, and various employees and members of such associations, have engaged in sabotage, property destruction, intimidation, and other actions intended to damage the business, reputation, property and employees of Reeves. Reeves is informed and believes that, among other things:

(a) The defendant Robert J. Matkowski, acting as agent for ACTWU and Local Union 2500, contacted an employee of Reeves and requested that the employee place a sand-like material into the foam manufacturing system at one of the Cornelius Plants, which would contaminate and make the system totally inoperative for a substantial period of time, during which period of time the plant would have to be closed. Analysis of the material indicates that the substance would also cause permanent damage or destruction to vital plant equipment, including pumps and mixing heads. The effected equipment produces the primary product for both of the Cornelius Plants, and the anticipated damage to this equipment would cause both plants to be closed for a substantial period of time due to the lack of basic product.

Matkowski furnished the Reeves employee with a diagram and detailed written instructions as to how to carry out the sabotage. Matkowski also furnished the employee with the sand-like material necessary for the operation.

(b) Matkowski also approached the same Reeves employee and requested that he pour a highly destructive chemical substance into the hydraulic systems of one of the Cornelius Plants. Analysis of the chemical substance reveals that this action would have caused a total failure of the hydraulic systems, which would have resulted in closure of both of the Cornelius Plants, because the Plants could not operate without the hydraulic systems. It would have taken at least one week to complete the repair of the hydraulic system, including complete replacement of all of the lines and pumps in the systems.

Matkowski supplied the employee with detailed written instructions signed by him as to how to carry out the sabotage, as well as the necessary chemical substance.

(c) Matkowski also requested the same Reeves employee to insert wire coils into Reeves' foam products. Defendant

Knox stated to the Reeves employee that he intended to supply the necessary wire coils to the Reeves employee.

(d) A member of ACTWU approached a Reeves employee who is not a member of the union and harassed, intimidated and threatened him by stating that he would do bodily harm to the employee if he did not support ACTWU.

(e) ACTWU and Local 2500 and various members of such associations have placed leaflets and other documents in products manufactured by Reeves at the Cornelius Plants and sent to Reeves' customers, which has damaged Reeves' relationships with its customers.

(f) Defendant Matkowski, Defendant Knox, and other members of ACTWU, acting on behalf of ACTWU and Local 2500 invaded the parking lot of the Cornelius Plants' personnel office. The ACTWU members prevented applicants from entering the personnel office and in fact intimidated potential applicants, causing them to leave the premises and not to apply for a job. The union members refused to leave the premises after being requested three times by a company official to do so. Eventually, Reeves was forced to call the Mecklenburg County Police in order to remove the ACTWU members from the premises. Matkowski was the leader and spokesperson for the group. A few weeks later, members of ACTWU again invaded the parking lot of the personnel office without the approval of Reeves.

9. In addition to the above-described actions, numerous other acts of sabotage, destruction of property, and intimidation and harassment have occurred at the Cornelius Plants, which Reeves believes is a part of the plan and conspiracy of ACTWU, Local 2500, and various of their members to damage Reeves, its property, its relations with its customers and its employees. Reeves is informed and believes that those actions include, but are not limited to, the following:

(a) On numerous occasions, continuing through this date, Reeves' products have been tampered with and damaged by the placing of nails, wire, steel rods, and other objects in Reeves' foam products, which were later shipped to Reeves' customers. The foreign objects were placed in the foam in a concealed manner, so that the objects would cause damage to the equipment of Reeves and its customers and prevent the foam from being usable by Reeves' customers. In addition, foam products have been cut in such a manner to render it unusable by Reeves' customers.

(b) Numerous conveyor belts have been intentionally cut, causing a shut down of operations within the Cornelius Plants and lost production.

(c) A polyol pump was intentionally and maliciously turned on at night, causing holding tanks containing this hazardous substance to overflow, creating a dangerous condition for employees and property and a substantial loss to Reeves.

(d) The tires on vehicles of Reeves employees who are non-ACTWU members and also those of management employees have been slashed and otherwise damaged by nails, both at the Cornelius Plants and at their homes. In addition, tacks, nails and other sharp items have been placed in the parking lots at the Cornelius Plants for the purpose of damaging the tires of Reeves' employees.

(e) Two fires of a suspicious origin occurred in one of the Cornelius Plants causing major smoke and water damage to the plant and the company's products.

(f) Telephone lines at the Cornelius Plants have been tapped and otherwise tampered with without the knowledge of Reeves, including a tap by which all telephone conversations by the Curon Group President could be monitored.

(g) The above-described actions and attempted actions are dangerous to the lives and health of employees of Reeves and its customers, and to the product and equipment of Reeves and its customers.

FIRST CAUSE OF ACTION
(Injunctive Relief)

10. Reeves incorporates by reference in this First Cause of Action paragraphs 1 through 9 above.

11. The above-described actions are illegal and in violation of the rights of Reeves.

12. The above-described actions of the defendants have continued to occur and Reeves is informed and believes that such actions will continue to occur hereafter, unless enjoined by the court. Such actions have and will continue to cause irreparable damage to Reeves, for which damage there is no adequate remedy at law.

13. Consequently, Reeves is entitled to a preliminary and permanent injunction, enjoining the defendants from:

(a) Intentionally damaging, destroying or tampering with any product, equipment, communication devices, production material or any other item of real or personal property of Reeves or its employees.

(b) Intentionally placing nails, wire, metal rods, or any other unauthorized foreign objects or contaminants in the foam or other products of Reeves;

(c) Placing any unauthorized documents, including but not limited to, leaflets or labels referring to the ACTWU or Local 2500 or any matter referring to Reeves, in or on any Reeves product or package;

(d) Threatening or harassing any of Reeves' employees;

(e) Trespassing on the property of Reeves;

(f) Preventing or attempting to prevent by mass picketing, violence, intimidation or coercion any person from freely and peacefully entering or leaving the Cornelius Plants;

(g) Otherwise taking any other action to damage, hinder, obstruct or interfere with the business, property, customers, or employees of Reeves; and

(h) Aiding, procuring, or causing to be done, directly or indirectly, any act which they are enjoined from doing themselves.

SECOND CAUSE OF ACTION
(Intentional Damage)

14. Reeves incorporates by reference in this Second Cause of Action the allegations contained in paragraphs 1 through 9 above.

15. The above-described actions of the defendants constitute an illegal, malicious and intentional destruction or damage to the property of Reeves, including its foam products, machinery and equipment, raw materials and plants, causing Reeves to suffer monetary losses.

16. Reeves is entitled to recover from the defendants, jointly and severally, its damages in an amount to be determined by the court, plus punitive damages and interest as allowed by law.

THIRD CAUSE OF ACTION
(Trespasses)

17. Reeves incorporates by reference in this Third Cause of Action the allegations contained in paragraphs 1 through 9 above.

18. The unauthorized entries of the defendants on the property of Reeves constitute willful and malicious trespass by defendants.

19. Reeves has been damaged by defendants' trespassing in an amount to be determined by the court, which damages Reeves is entitled to recover from the defendants, jointly and severally, plus punitive damages and interest as allowed by law.

FOURTH CAUSE OF ACTION
(Intentional Interference with Contractual Relations)

20. Reeves incorporates by reference in this Fourth Cause of Action the allegations contained in paragraphs 1 through 9 above.

21. Reeves has contracts with various customers pursuant to which Reeves sells its products to such customers.

22. The defendants, with knowledge of the contracts, took the above-described actions willfully and maliciously without reasonable justification or excuse with the intention of interfering with such contractual relations and causing Reeves'

customers to cease or reduce their purchases under such contracts.

23. As a result of defendants' actions, Reeves' customers did cease or reduce their purchases under the contracts, causing damages to Reeves in an amount to be determined by the court.

24. Reeves is entitled to recover its damages from the defendants, jointly and severally, plus punitive damages and interest as allowed by law.

FIFTH CAUSE OF ACTION
(Interference with Prospective Economic Advantages)

25. Reeves incorporates by reference in the Fifth Cause of Action the allegations contained in paragraphs 1 through 9 and 21 through 24 above.

26. Reeves has had contracts to supply products to the above-described customers for many years. Such customers have continued and increased their purchases over the years. Reeves had an excellent reputation with these customers and in the industry, in general. Reeves had a justifiable expectation that its sales to these customers would continue into the future.

27. As a result of defendants' willful and malicious actions described above, Reeves' customers have ceased or

reduced their purchases under the contracts, causing damages to Reeves in an amount to be determined by the court.

28. Reeves is entitled to recover its damages from the defendants, jointly and severally, plus punitive damages and interest as allowed by law.

SIXTH CAUSE OF ACTION
(Unfair Trade Practice)

29. Reeves incorporates by reference in this Sixth Cause of Action the allegations contained in paragraphs 1 through 28 above.

30. The actions of defendants ACTWU and Local 2500 as described above constitute unfair and deceptive trade practices in violation of G.S. § 75-1, *et seq.*, by which Reeves has been damaged in an amount to be determined by the court.

31. Based on the allegations contained in this Cause of Action, Reeves is entitled to recover its damages from said defendants, jointly and severally, which shall be trebled under Chapter 75, plus attorneys' fees and interest as allowed by law.

SEVENTH CAUSE OF ACTION
(Conspiracy)

32. Reeves incorporates by reference in this Seventh Cause of Action the allegations contained in paragraphs 1 through 31 above.

33. Reeves is informed and believes that the defendants and other ACTWU members have agreed and conspired to take the illegal and malicious actions described above, which actions have caused damages to Reeves in an amount to be determined by the court.

34. Based on the allegations described in this Cause of Action, Reeves is entitled to recover its damages from defendants, jointly and severaly, plus punitive damages and interest as allowed by law.

WHEREFORE, Reeves prays that:

1. The court enter preliminary and permanent injunctions against the defendants in accordance with paragraph 13 of the First Cause of Action.

2. Based upon the Second, Third, Fourth, Fifth and Seventh Causes of Action, the court enter a judgment against the defendants, jointly and severally, in an amount to be determined by the court, plus punitive damages and interest as allowed by law.

3. Based upon the Sixth Cause of Action, the court enter a judgment against the defendants, ACTWU and Local 2500 jointly and severally, in an amount to be determined by the court, which damages should be trebled, plus attorneys' fees and interest as allowed by law.

4. The costs of this action be paid by the defendants, jointly and severally.

5. The issues be tried by jury.

6. The court grant such other and further relief in favor of Reeves as the court deems fair and equitable.

This 18th day of June, 1987.

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Fred T. Lowrance

Max E. Justice
Max E. Justice

David N. Allen

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Senator METZENBAUM. Do you believe that pension assets should be used in mergers and acquisitions, or do you think that pension assets should be insulated from takeover efforts? My question is, why is your proposal silent on these issues?

Secretary BROCK. We do not think it is silent. We just think that the sum and substance of what we are proposing is to make these plans not an issue. We hope we will try to keep them from becoming an issue in that kind of a situation.

We would make it more difficult, obviously, for withdrawals, we would make it more difficult for terminations; we would impose must stricter standards on these plans. But we do not want them to become pawns in those kinds of struggles.

I do not believe, frankly——

Senator METZENBAUM. Well, they are pawns now, Mr. Secretary. In David Murdock's deal, he used the pension plan of Cannon Mills to acquire stock in Occidental Petroleum, and that coincided with his investment in a substantial number of shares of Occidental. He made a raid. He then got green mail, $60 million of it. And what happened? The employees did not benefit. Murdock then had the Cannon plan terminated, and he took out $25 million himself.

The pension plan was nothing more than a capital accumulation vehicle for Murdock, and it did not help the employees at all.

What concerns us is whether or not the Labor Department is willing to work with those of us in Congress to prohibit the use of pension plans for hostile takeovers, for the use of green mail, for two-tier offers, for these kinds of activities which contribute nothing to the economy, but the employees wind up getting the short end of the stick.

Secretary BROCK. Mr. Chairman, I think you have got to be very careful that we do not mix up apples and oranges. Our obligation under the law is to protect and hopefully improve benefit security under a defined benefit plan.

I do not want to get into a situation where we start prejudging what the plans can do in what they consider to be their own interest. I think the trustees of these plans have got to be given the responsibility of voting for the interest of those plan participants as best they define it, and it is very hard for us to prejudge whether a corporation is the subject of a good or a bad takeover. I do not know how to make those decisions for them. So I am going to be very cautious.

Obviously, if we can improve the security of the system, we will be happy to work with you. But I do not want to prejudge what that implies in terms of how they might conduct the plan.

Senator METZENBAUM. You hit the nail right on the head when you said the trustees have to be given the judgment to determine what is best for the plan.

Secretary BROCK. Yes.

Senator METZENBAUM. The letter that Marty Lipton sent out, and the letters that GTE and Rockwell sent out, instructed pension managers, on how they should vote the stock that they control, in connection with anti-takeover measures. That certainly has no relevance to the concerns of the pensioners, the retirees. And what I am asking you is will the Administration join with us in seeing to it that these managers operate totally independently, concerned only with the security of the fund and not get themselves involved in these takeovers.

Secretary BROCK. We are happy to work with you, but I want to point out the law does require that now. And I am not going to start justifying what lawyers do in this business—even in the Congress, Senator.

You are going to see that kind of example, but the trustees that follow that advice in defiance of the interest of their plan participants are in violation of the law.

Senator METZENBAUM. Congressman Clay?

Mr. CLAY. Thank you.

Mr. Secretary, do you believe that pensions are deferred wages?

Secretary BROCK. Basically, yes.

Mr. CLAY. Basically?

Secretary BROCK. Yes.

Mr. CLAY. What do you mean by that, "basically"?

Secretary BROCK. Well, I think you reach an agreement between worker and management on what the management is going to apportion to the work force and in what fashion it is going to apportion it.

It is a bargained process.

Mr. CLAY. If that is true, then why does your proposal require that deferred wages of one group of plan participants who are in overfunded plans be transferred to an entirely different group of participants in an underfunded plan, when the employer terminates the overfunded plan?

Secretary BROCK. Well, you are giving title to those benefits when they are overfunded, and the law does not do that, Congressman.

Mr. CLAY. No. What I am saying is if they are deferred wages, why would you take the wages of one group of employees, if they are in an overfunded plan, and transfer them to an underfunded plan? I just do not understand how you can take one employee's wages and give them to another employee.

Secretary BROCK. Well, first of all, they are not wages, Congressman. Let us be clear about that.

Mr. CLAY. Oh, now you are saying they are not wages.

Secretary BROCK. No. I am saying that we had a collective-bargained agreement where a certain apportionment to workers went to their direct cash benefits some to non-cash benefits; some went into the pension plan. But your own law, Congressman, does not give them a title of wages; never has, never did, does not now. So do not expand it for me.

Mr. CLAY. I do not believe that is absolutely true. If you want to check the law, we will find out that 1974 ERISA made it clear to me that these were wages——

Secretary BROCK. If it did, then why did it give the employers the opportunity to terminate and take those wages? If they are wages, they are not titled.

Mr. CLAY. They made it clear that these were not gifts, that they were wages, by the imposition of the rules. ERISA rejected the idea that these were gifts or somehow the property of management, when it established those vesting rules. It required companies to accrue benefits for workers over the entire work period, and it also required that in order to qualify for tax benefits, you could not discriminate against those highly compensated employees.

To me, it tells me that these are not gifts. That is what these rules say—this is not a gift that the employer is giving to the employee.

Secretary **Brock**. Congressman, the law is fundamentally and abundantly clear. We have a defined benefit plan. The apportionment that you would define as a wage is the defined benefit that is guaranteed by the company, and they are liable to maintain that commitment.

But what you are talking about is what goes above that, and there is nothing in the law that says the title of that resides with the individual worker—absolutely nothing. As a matter of fact, the law is abundantly clear that if there are an excess of assets over the actuarial responsibilities of the plan that that plan can be terminated and that the assets can be taken by the company.

Now, that is exactly what we are trying to address, but the law does not say that that excess accumulation, however derived——

Mr. **Clay**. Should it say it, Mr. Secretary?

Secretary **Brock**. No, no.

Mr. **Clay**. Are you familiar with the *Washington Star* case?

Secretary **Brock**. No.

Mr. **Clay**. Well, let me tell you about it, and I think it makes a good case for why you should have some kind of rules that would prohibit this. In that case, from the inception of that retirement plan it was always there that the fund belonged to the employees. The day before, I think it was, that they decided to take the excess out, the board of trustees of the company changed the rules to say that the fund now belongs to the company.

Unfortunately, the courts upheld that position. But do you think that is right? Do you think that is fair?

Secretary **Brock**. No, but I do not want to write U.S. law on the basis of one unfair action.

Mr. **Clay**. Do you think that there are other cases, or are you aware of any other cases similar to that, where they are taking the excess amount of money out to the harm of the participants?

Secretary **Brock**. No. I do not think that it is—well, I do not know what, if any, cases we have where assets are withdrawn and subsequently the plan failed. But what we have, Congressman, is a law that says when a company makes an agreement with a worker for a defined benefit plan, it is committed to pay that amount of money at the given point of time that the contract calls for; the company is liable, and that is an absolutely clear and legitimate case.

When you have an excess above that, the law also says that it can be terminated. We think that is unwise, and that is why we are proposing to change it.

Mr. **Clay**. Let me ask you what impact your proposal would have on collective bargaining agreements. If a company and a union sat down and negotiated an agreement that the assets of the plan belonged to the workers, would this proposal here nullify that in terms of the excess—or, when they terminate an excess plan, their being able to transfer money from the overfunded to the underfunded before the termination?

Secretary Brock. Mr. Kass says that it would only have an effect in a distress termination circumstance.

Mr. Clay. It what?

Secretary Brock. In a distress situation, that would apply.

Go ahead.

Mr. Kass. Yes. In the case of a distress termination where one plan of the control group terminates an insolvency, the application of the control group rule that is proposed here would impose or involve a claim on any assets in overfunded plans sponsored by the same employer.

So in that case, one could argue that these rules would contravene or supersede a collective bargaining agreement.

However, in the case of a withdrawal from an overfunded plan, if the plan documents—which, perhaps, were subject to a collective bargaining agreement—specify that no withdrawal may be permitted from that plan if that plan is overfunded, it does not seem to me that the collective bargaining agreement would be interfered with.

I think the main rub would be in the case of a distress termination of one plan where other plans are overfunded, and I think there is an objective there. The policy objective is that the situation of a particular plan within a control group with respect to its funding should not determine whether the benefit security of the participants in that plan is safe or impaired. Rather, all plans in a control group should be treated equally, and in that distress case, to protect the benefit security of the worker in the plan that is less well-funded, there ought to be a call on the assets in the overfunded plan.

Mr. Clay. I think you have answered precisely the question I asked, that this recommendation will nullify the collective bargaining agreement where they say specifically that the excess funds belong to the participants.

What you are saying—and correct me if I am misunderstanding it—is that in terminating the plan, as long as you satisfy all of the underfunded plans, that the excess belongs to the employer. Is that what you are saying?

Mr. Kass. Well, it has always been the case, Mr. Chairman—under current law it is the case—that a termination and reversion can take place only if it is in accordance with the terms of the plan documents and if it is in accordance with whatever bindings terms of a collective bargaining agreement may apply.

Now, that is the way the current law is. And as I said with respect to withdrawals from an overfunded plan, at least it is my sense that that is the way it would work in the future. The issue of concern, I believe, would arise where there is an underfunded plan in a control group and where an employer is at the same time maintaining other overfunded plans, and where the employer under current law could terminate that underfunded plan in distress, maintain other overfunded plans, some of which he may be able to terminate and take assets from because they are not subject to collective bargaining agreements and leave the participants in the distress terminated plan much worse off.

Now, interestingly enough, there is a sequel to that train of events that we have experienced in at least one or two cases, and that is where an underfunded plan is terminated; subsequently, overfunded plans are terminated and assets are withdrawn, and the responsibility for payment of those benefits in the underfunded plan falls on the shoulders of the PBGC.

The PBGC becomes the payor of first resort rather than last resort. We do not think that is good policy, either.

Secretary BROCK. There is a different issue, Mr. Chairman, if I can pursue the subject a little bit. I think it is fair to state that the general experience we have had is that there are more overfunded plans for management personnel than there are for workers. You, I assume, might agree with that.

Mr. CLAY. I do not know if that is true.

Secretary BROCK. Well, it is true. Now, what you have, then, is a situation that we are trying to deal with that says you cannot underfund your workers' plan and overfund your management plan; terminate your management plan, get some cash out, and leave an underfunded plan with a loss in benefits to your workers.

We are trying to reach that situation. I do not think that you are going to find in this kind of a situation that you are abrogating a collectively-bargained agreement, because the collective bargaining process goes to the workers' plans which, by the general rule, at least, will be more underfunded than those for management personnel. And what we are trying to do is to put some balance back into the process so that the companies cannot take advantage of that situation. So you will not be breaking the contract, you will be strengthening the collectively-bargained agreement.

Mr. CLAY. Thank you, Mr. Secretary.

Senator METZENBAUM. Thank you, Congressman Clay.

Senator Quayle, the ranking member of this Committee, we are happy to have you with us.

Senator QUAYLE. Thank you, Mr. Chairman.

Let me ask first for unanimous consent to put my opening statement in the record, since I was not here at the outset.

Senator METZENBAUM. Without objection, it will be included in the record.

Senator QUAYLE. Mr. Chairman, let me first of all congratulate you and the chairman from the House for having these joint hearings. I have found in the past with the joint hearings, when you can get the House and Senate together to sit down, particularly on an extraordinarily complicated issue like this, that we are going to have to come to some sort of a consensus rather early on in the process to be able to move this forward, and I think that the best way to do it is to sort of hash it out and have everybody here and call the witnesses. So I applaud you for that procedural decision.

Senator METZENBAUM. Thank you.

Senator QUAYLE. I want to congratulate the Secretary for putting forward a rather bold, imaginative proposal that he feels—and I tend to share his feeling—that this is going to increase pension security. That is what the bottom line is: stability, security, to make sure that there is an independent honesty with these plans. I think that he has made some very good recommendations.

Just listening to the debate here, I think we have to start out, particularly as we look to the overfunded plans, and have perhaps a philosophical and/or legal determination about to whom excess funds really belong; a philosophical argument concerning who owns these excess pension funds. I think we are going to have to try to search for some sort of common ideological ground here before we really begin to proceed on how we are going to best get results.

So, Mr. Secretary, would you like to help me go through this discussion from a philosophical point of view and a legal point of view, concerning the excess funds of these pension plans?

I think there is probably or maybe not—a misconception of what a defined benefit plan really is. You have pointed out that a defined benefit plan is determined by contract, by formula, and it will say what the employee is to get at a certain given time.

Both the responsibility for underfunding and the benefits of overfunding are the employer's in a defined benefit pension plan.

So would you take us through this argument, to try to form some sort of a basis as this joint House and Senate committee can proceed? I detect that this is going to be a very important point and that we are going to have to have some commonality, or at least understanding of the issue.

Senator METZENBAUM. I do not want to debate with my colleague, but you have hit at the nub of much of the issue, where I think it is fair to say the Labor Department feels very strongly, and some employers as well, that the excess funds belong to the employers, and once they have met the defined benefit obligation, that is it, and the rest of the money belongs to them.

Many of us in Congress—and I will not say that it is unanimous, because it is not—recognize that the language provides that the funds are to be used for the exclusive benefit of the participants. I have the feeling that if we get that issue resolved, when we get that issue resolved, we will be some time into the 21st century. We may have to figure out a way to find a middle ground or a rationale or a rational compromise that is liveable for all parties in order to move this bill. But I certainly do not wish in any way to preclude the Secretary from responding.

Senator QUAYLE. Some people say that the excess surplus, no matter what, has to go to the employees; some say that the excess surplus, no matter what, is the employer's money. I happen to feel that you can look at this thing and maybe define something that you are going to be able to satisfy both interests. If you cannot, then we are probably going to be left with, perhaps, current law, the current situation, which I am not so sure is what the Chair wants, what I want, what the Secretary wants.

But I think that it is very important to attempt, before the 21st century, and particularly—you know, I have always been one who believes that if you really are looking at enhancing the productivity in this country, that you really have got to come together with good labor-management relationships. And since this is a contentious issue in labor-management, and it is a contentious issue even in the Congress, I think that we ought to have a rather plausible, genuine discussion of this philosophical and legal determination about these excess funds. I think it would probably help to enlighten members of the Committee before we get into some of the complexities, because when you get into a complex issue like this, I find you can always pull out court cases or legal rationale or a certain number of statistics to sort of come to your point; but if you do not have a basic understanding of the philosophical underpinnings of the issue it is more difficult to evaluate the legal facets of the problem, and arrive at a common conclusion.

The Secretary, who has been a good steward of this administration and has been a good Senator before this, understands what he has before him. I would like to hear him expound on what he thinks the most significant arguments—both the philosophical, and the legal—regarding the disposition of excess pension plan assets.

Secretary BROCK. I would be happy to. Let me make two points to begin with. First, you have already demonstrated that you do not need a whole lot of help. I appreciate the invitation, but I also appreciate the knowledge that you bring to the subject.

Secondly, the Chairman has already described the Administration proposal. It is the middle road; it is the logical answer to all these problems. That is exactly why we are here.

Senator QUAYLE. He is saying you are over there, I am over here, and you are in the middle.

Secretary BROCK. That is right. We are coming right in-between.

Senator QUAYLE. Yes, there you are, there you go.

Senator METZENBAUM. One man's middle of the road is another man's end of the line. [Laughter.]

Secretary BROCK. Okay. Let me draw back for a minute and recall when we wrote ERISA 13 years ago, or thereabouts, at that time the pensions of this country amounted to, if I remember correctly, about $400 billion. They passed $1 trillion some time ago. They will pass $2 trillion in the not too distant future, probably within 5, 6, 7 years.

We have a system that ain't broke; we have a system that has done the most incredible job of providing retirement to the people of this country that there is in the world. It makes all Government systems dwarf in comparison of performance. It is spectacularly good. We are the envy of the free world and all the rest of the world. There is no place in the world where capital formation comes about so readily as a consequence of an agreement between worker and management, and the worker benefits in the process with a really important retirement security opportunity.

So we have a very, very remarkably defined system that has done a heck of a good job, and let us be very sure that we do not do anything to impair that.

Secondly, in looking at the philosophical question, if you will, when the Congress wrote ERISA we made a distinction between two kinds of pension commitments. On one side there were defined benefit plans. On the other side were defined contribution plans.

Now, John Ehrlenborn, who is here, could articulate this far more eloquently than I, but the fundamental difference is that when you said, I am going to make a defined contribution, you are saying, I am going to contribute this amount no matter how much it yields to you when you retire.

Now, most workers really preferred a defined benefit, which says how much they were going to get when they retired. And that is what we decided to insure and to regulate on the part of the Federal Government.

In both cases, the company has an obligation. In the defined contribution plan, the company has an irrevocable commitment to continue those contributions, period—cannot break it with that employee. In the defined benefit plan, they have a different kind of commitment, and that is to be sure that the benefit is paid regardless of what kind of contribution is takes to make that benefit achievable.

We decided to guarantee that in order to provide a greater incentive for these plans to be created and to provide a greater security for workers. The incentive is there. We have had an explosion in plans and plan benefits. As I mentioned, the assets have gone from $400 million to $1 trillion and are going quickly to $2 trillion. That is an awesome amount of money.

If you look at the legal or ethical question, if you will, the philosophical question, I am not sure that any of us really wanted to try to answer these things in terms of ownership or title. What we wanted to do was answer the question of obligation and responsibility. And that is what we are dealing with—not title, not some piece of property, not a deed, not a lien—but an obligation, a commitment, that a company has to see to it that that benefit is paid out of a plan that is fundamentally sound and is financed in such a fashion that the benefit will be paid, and no matter what happens to the company in the future, that benefit is going to be there for that worker. And we in Government decided to back that up; we charge a premium to do this, $8.50 a worker, but in exchange we provide a guarantee that no matter what happens, again, that that benefit will be paid on the defined basis.

I never really like to debate the question of title, because I do not think that is a relevant question. I think the question of obligation and responsibility is a relevant question. And what we have is a system that, not by design but by inadvertence in the writing of the original bill, has the wrong kinds of incentives in it. There are incentives in the present system to either overfund, because of the tax reduction you get, or to underfund because you might be able to keep more cash in the kitty for other purposes if you are in troubled circumstances. But the incentives are not sufficient to maintain the security of the plan as close to the defined benefit requirement as it ought to be.

What we are proposing and what we are asking of the Congress is the opportunity to sit down and see if we cannot write rules that change the mix of those incentives to make it a disincentive, to increase the disincentive for underfunding, and increase the burden for underfunding, to increase the disincentive for overfunding and therefore for terminations, but to do so in a fashion that keeps people putting these plans into existence.

The one thing we do not want to do, Mr. Chairman, is to throw the baby out with the bath water, to have a problem, which we do in underfunded plans, which are a minority, and overfunded plans, which are a distinct minority, and in trying to address those two problems, to create a new answer that creates a disincentive for the participation of the defined benefit plans. That is what we must not do, and we have got to be very careful that we do not get into troubles over words or polemics about who benefits, but rather, that we act to define this circumstance in a fashion that extends and increases the opportunity for pension benefits to be negotiated between workers and management. That is what it is all about.

Senator **Quayle**. Okay. I accept that distinction of not getting into the legal title of the funds, but to focus on the obligation from an ethical, moral responsibility and what the objective of your fiduciary responsibility is as Secretary of Labor.

Under current law, can an employer terminate an overfunded pension plan, and take those excess funds out and start up all over again?

Secretary **Brock**. Sure.

Senator **Quayle**. He can do that now?

Secretary **Brock**. Absolutely.

Senator **Quayle**. So under the law, he can go in and terminate that plan and take those excess funds out?

Secretary **Brock**. Yes, he can.

Senator **Quayle**. I think what I have heard thus far—that that is a concern, and that is one of the major issues that you tried to address in your legislation, is to provide different incentives for termination.

Secretary **Brock**. Absolutely, we do.

Senator **Quayle**. And what are those different incentives that would enhance opportunities and help the employees out in the long run on that termination of the excess pension?

Secretary **Brock**. The most important one is to allow——

Senator **Quayle**. Excuse me. I am having a difficult time hearing you, Bill.

Secretary **Brock**. When I get serious, I get quiet.

Senator **Quayle**. I thought you had laryngitis. [Laughter.]

Secretary **Brock**. I will not comment on that.

Senator **Quayle**. What are the incentives in your proposal that would try to get away from this?

Secretary **Brock**. What we are proposing to do is to allow for the withdrawal of assets without the termination of a plan. We really are uncomfortable with these plan terminations, in all honesty. Obviously, they are statutorily allowed. The question is whether it is the right thing to do, and that is something that bothers us.

What we are trying to do is to say, okay, there will come a time in some situations where you have got an explosion of the value of the stock components of a particular portfolio that goes up and allows you to have a substantial excess that you may want to recapture for other purposes, to create more jobs, to create more growth, to deal with the corporation's problems, whatever.

We want to allow access to those funds for the well-being of the company and its workers, but we do not want to do it at the risk of impinging upon the benefit security. So what we say is that to do that, you can only take the excess assets when they exceed 125 percent of what would today be a statutory requirement. In other words, we would cushion in a 25 percent.

In addition, if you want to terminate, we say if you terminate, do not come back here saying you want to put a plan in next year, because we are not going to let you do it; you cannot provide a comparable plan to those same workers unless you wait for 5 years.

That is a significant disadvantage to any firm that wants to have a healthy and a productive work force.

So we are trying to discourage those things.

Senator QUAYLE. You are trying to basically discourage these plan terminations. I mean, that is an objective on the overfunded plans.

Secretary BROCK. That is right.

Senator QUAYLE. Now, let me just turn for a quick moment to a couple questions on the underfunded plans. How big a problem are the underfunded plans, and is it concentrated in certain industries or certain groups?

Secretary BROCK. It is a large problem, and it is basically pretty well-concentrated. I think I said earlier that our unfunded liability, Kathy, is probably about $45 billion.

Dr. UTGOFF. At least that.

Secretary BROCK. At least that, in underfunded plans; and that at least half of that is concentrated in somewhere between 25 and 35 firms. So it is very well-focused in a couple of areas.

Senator QUAYLE. In looking at the review of those 25 or 35 firms, do you have any pattern of corporate activity that has led to this underfunding? Can you say that there is some past practice that may be the waiver of the minimum funding requirements or whatever——

Secretary BROCK. Dr. Utgoff is our resident expert. Let me turn to her.

Dr. UTGOFF. Waivers have in fact sometimes been a problem.

Senator QUAYLE. Waivers have been a problem.

Dr. UTGOFF. Yes. But the underlying reason that these problems have been generated is that when companies get into trouble, they have strong incentives to use their pension plans as a cheap source of corporate financing, so that when we look at healthy companies, they have strong incentives to fund their pension plans well because of the tax incentives. But when you are not making any money, tax incentives are not important to you. So that we often see that employers who get into trouble—which is precisely the wrong time to take money out of your pension plan—often do that, because it is cheaper to take it out of your plan than it is to get it from a bank. So they either——

Senator QUAYLE. They borrow from it?

Dr. UTGOFF [continuing]. In a sense, borrow from it by not contributing. To be specific, they are not actually taking it out; they are cutting their contributions back or in fact getting total waivers for the contributions so that their underfunding grows year after year. We have seen many companies—as we talked about before, LTV's Salaried Republic Plan had $7,700 in it when it was terminated, and it never had a funding waiver.

Alice Chalmers had 3 percent of the present value of their benefits, 1 month of benefits, when they terminated. These were troubled companies that decided that they had better uses for the money, and——

Senator QUAYLE. And were they operating under the law?

Dr. UTGOFF. Yes.

Senator QUAYLE. They were operating under the law, and it was all legal what they did——

Dr. Utgoff. Yes, it was all legal.

Senator Quayle [continuing]. And got themselves into this predicament.

Dr. Utgoff. For the most part.

Senator Quayle. For the most part they were operating legally—or you assume that——

Dr. Utgoff. Right. Senator Metzenbaum has asked us to look into a number of these cases, and we are investigating them. But for the most part, the problem has been that the companies needed the money, and they acquired extra financing by not contributing to their pension plan.

Senator Quayle. What does this bill do to try to remedy that situation? Do we have anything in there to——

Dr. Utgoff. Yes. It contains changes in the minimum funding standards that will go a very long way to correct this problem.

Senator Quayle. Okay.

Mr. Chairman, thank you very much.

Thank you, Mr. Secretary.

Senator Metzenbaum. Thank you.

Congressman Owens, do you have any questions?

Mr. Owens. I have no questions, Mr. Chairman.

Senator Metzenbaum. Thank you.

Congresswoman Roukema?

Mrs. Roukema. Thank you, Mr. Chairman.

I do not know whether we are still trying to find middle ground, but I cannot resist asking this question even though we may have beaten this horse for as long as we should be beating it today.

The question is that as I understand it the DOL ERISA Advisory Council did recommend that some portion of these excess assets be used for benefit enhancement upon termination. You have obviously made a conscious decision not to take that recommendation, and yet it seems to me that that might be the middle ground here, in recognition of the excess assets question dilemma that we are in.

Would you care to commend on that, either the Secretary or Mr. Kass?

Mr. Kass. Sure. I think it is important to know where that number came from, that 20 percent surcharge that was proposed by the Advisory Council. And quite frankly, it did not come from an opening position that the workers' own a portion of the surplus and ought to be entitled to it, and the amount they ought to get is 20 percent.

Rather, it came from the fundamental objective of the Advisory Council to discourage terminations, and after creating the option of a withdrawal and with a view toward preserving the current law availability of spinoff terminations and termination reestablishment, the Advisory Council concluded that the only way those kinds of transactions could become essentially equivalent on a financial basis, since there was a cushion required in the case of a withdrawal, would be to impose some surcharge on a termination, and after a surcharge was defined that would result in rough equivalents, the question was what do you do with this 20 percent.

And in wrestling with that issue, it was the collective view of the Advisory Council that it should be used to enhance the benefits of retirees.

Now, I think what you have to look at most importantly is that key objective of discouraging terminations, which our proposal has approached through another method. And I think there is one other very important aspect that we have to bear in mind here.

A surcharge on an overfunded plan, in essence, involves mandating a higher benefit only for plans that are overfunded, okay? And that will produce some, I think, unfortunate and negative incentives in that if an employer knows that the more he funds the plan, the more liability he has, there is less incentive to fund properly. So in a sense it creates a perverse disincentive to proper funding of a plan.

Our objective, as I said, was to discourage terminations. And as the Secretary has brought out, the way in which we do that is to provide a flexible and attractive alternative to terminations and to prohibit employers who terminate their plans from doing what they probably want to do, which is to cover their workers with defined benefit plans. We think that is the better approach.

Mrs. ROUKEMA. Thank you, Mr. Kass, Mr. Secretary, did you want to comment?

Secretary BROCK. I just wanted to say parenthetically, I was intrigued by the 20 percent proposal, and we did think about it quite a bit and talk about it quite a bit. I think the compelling logic that Dennis just mentioned, that we did not want to create a disincentive for adequate funding, and that was the point that we were aware of. There was almost an additional reason that has nothing to do with substance at all, and that is that everybody wanted the money. And I could not figure out whether we should take it into the Department of Labor budget where I wanted it, or give it to Kathy over in PBGC or put it in Treasury. And everybody was screaming.

The fact is that it is not anybody's money per se. We really did not want to create any circumstance where we were creating a disincentive either for plan formation or for precise funding.

Mrs. ROUKEMA. I think you have clearly indicated that every action has a reaction, and we do not want to do something that will be ultimately more adverse than what is existing.

But I have got to say, I think these committees have got to rethink that issue. That may be one avenue of dealing with the excess assets where we might reach some consensus.

But I do have a question—I do not know how to state it except to be open-ended about it, and present it for your comments, because it is a large question that has not yet been addressed at this hearing, and that is the question of the health benefit component. We are underfunded, as I understand it, by at least $100 billion. But I would like to have comments from the Secretary and from staff as to more specifically how you want to attack this problem. It seems to me that it is at least as large a problem as the other, particularly as it is a part or a component of the national debate that we are about to enter into on the subject of catastrophic illness coverage under Medicare and long-term illness coverage in a nursing home. Certainly, the way private pensions deal with the health needs of their retirees has got to be a major element in that debate, and it is our obligation here to deal with that subject.

Will you comment further on how you propose to deal with the $100 billion deficiency as we look into the future on this issue.

Secretary **Brock**. Well, I was going to say we do not deal with it here.

Mrs. **Roukema**. You cannot.

Secretary **Brock**. The problem really is awesome, and I am not sure that any of us has a very good answer. I am delighted the conversation is beginning because it is something we have got to answer in the fairly near term. We are building up very substantial unfunded obligations here that are going to impact upon the system and upon workers' retirement welfare in the not distant future, but rather in the near term.

What we do here is to make just a couple of very modest changes. First, we allow for the withdrawal of assets in excess of 125 percent of those required for a defined benefit plan to be applied in that company's health plan for existing retirees so that they can use that to continue those benefits if in fact they want to do it and some will. We think that will help some workers and some firms.

Secondly, we propose to change one section of the law which required, I think, if you had a health plan that no more than 25 percent of the funds, was it, Dennis, went into the health plan.

I do not believe that there is any logic to saying what percent should go into health versus retirement. Frankly, for a lot of older folks, health is a lot more important than the retirement benefit. We should not be making those kinds of judgments, but we made that very modest suggestion.

But in the longer term, we have got to see if there is some way we can increase the funding and the actuarial soundness of that health benefit promise that has been made, because that $100 billion is sitting out there, and that is a lot of money, and there is nothing in the bank to pay for that $100 billion. We may have made more commitments than that, but that much, we are fairly confident is not funded, and it may be more than that, but it is at least that much.

I guess one of the problems Roger might want to comment on has to do with where do we get the money, because you are talking about a very large sum of funds.

Mrs. **Roukema**. Mr. Mentz, please.

Mr. **Mentz**. Well, that is exactly right. The concern here was if we went any further, there would be an additional revenue cost that we did not think would be appropriate for this proposal.

Also I think in order to deal with this subject of not just retiree but current employee promised health benefits, you have to take kind of a comprehensive look at it. You look at whether the discrimination rules have to be improved. It is the same sort of an approach the needs to be taken that was taken in the ERISA and following ERISA.

I think this is not intended to be, as the Secretary said, a comprehensive approach. It is intended to be a small step that is undeniably a benefit to corporations with well-funded plans. It can move some assets to meet other liabilities without any tax. There is no income tax, there is no 10 percent excise tax, because there is no withdrawal of the funds out of the pension plan. That is basically the tax side of it.

Mrs. ROUKEMA. I just hope we can do something significant in this legislation on that aspect. There is a lot of talk, and particularly in our own party, about a public/private sector partnership so that we do not have to expand Medicare for long-term care, and I think if there is anyplace that we should first look for that kind of a partnership, it is here through the pension system.

But I think what you have said is it is very, very difficult to do.

Secretary BROCK. It is difficult, and it is expensive, and I think all I would urge is that we begin the conversation, but we do it with a great deal of caution. We really need to put a lot of thought into this. It is a problem the country has to deal with, that cannot be postponed. But neither can it be rushed. We have to do it right if we are going to do it at all.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

Secretary BROCK. Mr. Chairman, I am running into a problem on time.

Mr. CLAY. Yes, I understand, Mr. Secretary, that you have to leave. If there are any questions for the administration, I am sure that you will be willing to leave your staff.

Secretary BROCK. Well, these folks know a whole lot more about this than I do, so now you will get some good answers here.

Mr. CLAY. Well, we certainly want to thank you for your testimony this morning.

Secretary BROCK. It is nice to be with you. Thank you very much.

Mr. CLAY. We will see if there are any questions for your staff, if they might remain for a second or two.

Secretary BROCK. Fine.

Mr. CLAY. Mr. Murphy?

Mr. MURPHY. Just one question. The difference between obligation and property rights seems to be rather fuzzy. The Secretary said it is not anybody's money. If we deal in legislation to correct the problem, we have got to deal with property rights. I think it is incumbent upon the administration as well as us in Congress to finally decide whether this is going to be a property right and whose property it belongs to.

I think the overfunding occurred in many instances not because the companies were putting in more money, but because they either wisely or luckily invested their money, and that produced the overfunding.

Now, what I am getting to is that we must, I think, come to a determination that this may be a property right, and I would suggest that it is certainly not the employer's property right. But I would ask the witnesses, do you advocate that no one should be able to withdraw on an overfunded plan if they are in any way connected with an underfunded one, either through a subsidiary or any other type of corporation? How do you feel about that?

Mr. KASS. The way the rules would work with respect to withdrawals from plans is that there would have to be assets above a defined level, not only in the plan from which the——

Mr. MURPHY. The 125, or——

Mr. KASS. Right. That is termed in this proposal a minimum benefit maturity level.

Mr. Murphy. But what I am talking about is the many instances where you will have an LTV out here where they have one group of employees that is underfunded and one that is overfunded.

Mr. Kass. Yes, that is the point I am going to get to, sir. The point I was about to make is that the funding adequacy has to be not only in that plan from which the money is going to be withdrawn, but from all of the plans in the control group of which that plan is a member. That is to say that if annuities are not purchased with respect to accrued liabilities that the funding in the entire control group would have to be equal to or in excess of 125 percent before a dime could be taken from any overfunded plan in that group.

Mr. Murphy. How about our ability to transfer an overfunded plan to an underfunded plan?

Mr. Kass. Well, the place we care about that is in the case of the termination of that underfunded plan. And this proposal in the case of a termination of an underfunded plan would mandate transfers to a defined extent from overfunded plans, indeed from plans that have assets in excess of their termination liabilities, to a terminating underfunded plan that has assets that are below the termination liabilities of that plan.

So in certain circumstances, transfers would be more than possible; they would be mandatory.

Now, if I can get to your first question about property right. If there is a property right concept to be applied in this context, it is a property right to a defined benefit. A defined benefit plan is not about the routable allocation to participants of the assets in the fund. What it is about is an employer obligation to fulfill under all circumstances a benefit promise.

If the employer has assets insufficient to meet the benefit promise, the effect of the minimum funding rules is intended to be, and indeed the effect of these proposed changes in the minimum funding rules will be that the employer will move toward the full funding of that promised benefit quickly.

A defined contribution plan is characteristically different from a defined benefit plan. In that case, there is a vested account balance where there is ownership of the assets in the individual account by the participant. But there is a very important distinction in terms of benefit security, and that is, in the defined contribution plan, if the investment performance of the funds in the account is poor, then it is the employee who at retirement suffers a less dignified, less affluent retirement than would have been the case of a targeted level of benefit had been achieved.

That is not the case in a defined benefit plan where the whole objective is to provide a stable, predictable, and secure retirement income to workers, and where the employer is on the hook to make contributions sufficient to pay that benefit.

The effect of the changes in the minimum funding rules will be to move us in that direction. That is my view of the property right.

Mr. Mentz. Mr. Murphy, I wonder if I might try my hand at this question as well, the question of who has the rights to these excess assets.

Under current law, the liabilities of an employer are not clear and not up to whatever the pension promise is to the employees. In other words, you can have a pension plan, a defined benefit pension plan, that makes a promise of so many dollars, but the employer is not personally liable for that promise.

This proposal would change that. This proposal would make the employer personally liable for every defined benefit promise made to every employee as a major step.

A second step is through the funding rules, the proposal would ensure that plans are adequately funded so that an employee's promise is better-secured; we are not going to have the major serious underfunded plans that terminate that has been happening in the past.

And a third point is because this proposal looks at a variety. really, all the defined benefit plans of the employer, indeed, even the control group—so that if you have a parent and a subsidiary that each have defined benefit plans, this proposal would aggregate them. And if one is overfunded and one is underfunded, you cannot terminate the underfunded plan and cheat the employees out of their benefit promise. It has got to be combined, and assets may have to be moved, but the net effect is a much more secure employee promise.

Now, that is what a defined benefit plan is all about—a promise of retirement income to an employee. What we are trying to do is have a very secure method of requiring the employee to provide that promise, and we are saying if he does so, and if he does so for all of his employees in all of his defined benefit plans, plus a cushion—the 125 percent that has been talked about is the cushion on the assets—if you get above that, that extra, because of investment performance or whatever, it is appropriate that that go back to the employer. That is the mechanism that is provided here through withdrawal. I think that is a perfectly defensible and proper result.

So my answer, I think, is a very clear one, that once you are through all the funding obligations imposed by this plan and the employer liability side of it, anything excess, that is in excess of the employer promise, and that should go back to the employer if it exists.

Mr. Clay. The time of the gentleman has expired.

Mr. Sawyer?

Mr. Sawyer. Thank you, Mr. Chairman.

Let me return to a problem that is specific to my community. I represent a district that includes Akron, OH, which has been the site of a number of hostile takeover attempts in recent weeks.

And I thought I was moving toward an understanding of what the Secretary was talking about until we got to this point of those assets being nobody's money in reality. That comes very much into play where, in the case of the aggressive investor, in some cases whose purpose it is to strip assets of a company that he may view as being flush, the degree to which this repository of capital in the case of the overfunded plan becomes a lure, a magnet of sorts, to that kind of hostile behavior.

Then, second, I suppose, the degree to which you do that is healthy, unhealthy, or perhaps irrelevant to the question that we are discussing this morning; and third, the degree to which those assets—100 percent or 120 or 125 or beyond—ought to be isolated from that kind of asset-stripping activity.

Is my question clear?

Mr. **Kass**. Well, you have several.

Mr. **Sawyer**. Yes. I have three, I think.

Dr. **Utgoff**. I think one of the things you have to talk about is how frequently are these asset reversions, these excess assets, involved in corporate takeover battles. And there have been a number of studies on this, and although they receive a great deal of publicity, and there has been some involvement, by and large the intersection of corporate takeover activity and excess assets in pension plans is a very, very small minority, a small percent. And even in those cases, the amount of money that is taken from the pension plan involved in the corporate takeover in terms of the total value of the taken-over company, is very minuscule. So that it is very hard, when you look at the evidence, to say that it is a significant lure.

Now, sometimes, a corporate raider believes he needs all the cash he can get to do whatever he wants, and you may want to talk about corporate governance rules. But to attack whatever problems you see with corporate governance rules through a very, very tiny involved pension plan, changing anything about pension law, is really taking the dog and wagging it by the tail.

They have been associated, but the problems in some cases can and should be separated.

Mr. **Sawyer**. Mr. Chairman, if I could pursue for just a second.

Mr. **Clay**. Go ahead.

Mr. **Sawyer**. I can understand how it is, in the total scope of the matter, a relatively small component in the entire asset picture that an investor might be looking at. But it seems to me that in answering that kind of question, we get perhaps at the heart of whose money it is, and whether or not it is an asset that ought to keep protected for the purpose for which it was developed, or ought perhaps to be an asset that is amenable to that kind of——

Mr. **Kass**. Our objective is to protect the assets for the purpose that they are held in trust to serve. And indeed, that purpose can be expressed as the value of the liabilities that the plan sponsor is obligated to discharge. And so the objective of funding should be to have sufficient assets in the plan to discharge those liabilities.

It is not good pension policy, and it is probably even worse economic policy, for assets to be held in pockets, if you will, of the economy where they cannot be used most productively. And one of the objectives in a broad economic context of the withdrawal rules, as the Secretary said in his concluding remarks, is to make assets that are not needed to discharge the projected pension obligation available for the creation of jobs and for the expansion of the economy.

Now, it becomes, as he also pointed out, very problematic to identify which of the business combinations will result in that favorable and desirable outcome and which business combinations would not. And as he pointed out, the purpose of pension law should not be to arbitrarily make determinations as to how surplus assets are going to be used.

Mr. **Sawyer**. One final question, Mr. Chairman. Clearly, I would agree with that it could be a case of a very small tail wagging a very large dog.

But my question, I guess, in its final form is to ask you whether the protections that you would apply to the employer would continue to apply in the more fluid circumstance of this kind of change in ownership.

Mr. KASS. Oh, you bet, yes.

Mr. SAWYER. Thank you.

Mr. CLAY. Mr. Jontz?

Mr. JONTZ. Thank you, Mr. Chairman.

I would like to return to the subject of underfunded plans for just a minute, if we might. My understanding of the administration's proposal is that there would be restrictions on the conditions under which a minimum funding contribution waiver would be granted. What are the circumstances that the IRS now looks at in allowing a waiver to be granted?

Dr. UTGOFF. Right now, the IRS looks at waiver requests, and under those waiver requests, the company must show that it is in distress and that the granting of the waiver would be beneficial for the continuation of the plan.

So that they review the waiver request to make sure that the plan can in fact have some chance of continuing, and that the denial of the waiver in some cases is believed to be something that would precipitate a plan termination that would not otherwise occur.

So the basis for the waiver is to protect the plan participants.

Mr. JONTZ. Are there cases now, or have there been cases, where PBGC made a recommendation against a waiver and the IRS went ahead and granted it?

Dr. UTGOFF. In the past there may have been some differences. But in the recent years since the passage of SEPPAA, we have established a very close working relationship with the IRS and in fact, both of the agencies have reviewed funding waiver requests, and generally, the IRS has taken our input and not granted a waiver when we feel it is not in the interest of the plan participants.

Mr. JONTZ. To look at the case of Continental Steel——

Dr. UTGOFF. Yes, right. That was before this last year.

Mr. JONTZ. Could one argue under any circumstances that the repeated waivers which were granted to Continental Steel were in the interest of the participants?

Dr. UTGOFF. Right—I think the outcome of that, five consecutive waivers, is stark testimony to the danger of granting waivers without good protections. And the procedures for reviewing waivers and the requirements under which they are granted have been changed, and I think those changes may have in fact been caused by some of the obvious Continental Steel cases.

Mr. JONTZ. Could you describe what would have happened in the case of Continental Steel had these proposed new rules been in effect?

Dr. UTGOFF. Well, the new rules would have limited the waivers to three instead of five. They would also have required higher funding standards from Continental during the period of that 3 years, and it would have required faster amortization periods of the waiver and an effective higher interest rate for the repayment of the waiver, so they would have been less attractive.

Mr. **Jontz**. Just for purposes of speculating, what do you think would have happened in the Continental situation had these particular requirements been in effect? What would the end result have been?

Dr. **Utgoff**. Well, there is an incredibly long history of the involvement of the PBGC and Continental; it was first Penn Dixie, and then Continental went chapter 11, then it went chapter 7. So I think that the resolution of the plans probably would have been sooner. They would have been less underfunded, and the company would have had to make an agreement to go with another kind of pension arrangement for their employees much sooner than at the last day of the survival of the company before it was liquidated.

It really was a very difficult, challenging situation over these last few years.

Mr. **Clay**. The time of the gentleman has expired.

Senator **Metzenbaum**. Thank you very much.

I want to thank the panel for their cooperation.

We are doing very well as far as time is concerned. We had 1 witness; we only have 12 more, and we took 2 hours for the first one.

Senator **Metzenbaum**. The Chair will have to set a time for the next panel. The next witnesses are: Edwin Ballas, a union retiree from LTV Corporation, Newton Falls; Richard Cecconi, a salaried retiree of LTV Corporation, Warren OH; and Steve Knox, an employee of Reeves Brothers, Cornelius, NC

Each of the witnesses will be given an absolute maximum of 4 minutes. We will turn the yellow light on at 3 minutes and the red light will go on at 4 minutes, and you will then have 1 minute to summarize.

Mr. Ballas, we are very happy to have you with us. Please proceed.

STATEMENTS OF EDWIN BALLAS, UNION RETIREE, LTV CORP., NEWTON FALLS, OH; RICHARD CECCONI, SALARIED RETIREE, LTV CORP., WARREN, OH, ACCOMPANIED BY PAUL WALTERS, AND STEVEN KNOX, EMPLOYEE, REEVES BROTHERS, CORNELIUS, NC

Mr. **Ballas**. Thank you very much. My remarks will be brief, but I assure you that what LTV did to the pensioners is astronomical.

I am Edwin Ballas; I am 58 years old and had 36 years of service at LTV when I retired on March 31, 1986.

The company approached our local union at its Warren plant with a management proposal to reduce the number of employees at this plant. They referred to it as "the Warren strategy", with a threat of possible shutdown unless we agreed to it.

In effect what the plan did was to expand the duties of the employees. In return for this agreement, the company agreed to let those employees meeting the so-called "magic numbers" or 70–80—that is when you take your seniority and your age, and if it comes up to 70 or 80, you qualify for the plan—and they could retire if their job could be eliminated. That is how I retired.

Now the company took back their $400, expanded the duties of the remaining employees, and are still in business, working overtime.

The company has it all. I feel that I should receive the $400, or my job should be returned. My pension totals $1,067.08. My contribution to the insurance plan is $53.78 plus $113 for income tax. Take the $400 off, and you have $500 a month to live on.

If in the future, I have to purchase additional health insurance, this could be another $150. How are we to survive?

In addition, some of my fellow workers lost over $200 from their original pension in addition to the $400.

This type of management cannot be tolerated. The Government must step in to prevent situations like this from occurring. I feel the company should be forced to either sell out or in some way find the money to pay these debts and not cause all this hardship on people—and then do business as usual.

Those are my comments, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Mr. Ballas.

Mr. Cecconi, accompanied by Mr. Paul Walters, of Cleveland. We are happy to have you with us, Mr. Walters.

Mr. CECCONI. Thank you, Mr. Chairman.

I would like to express my appreciation for the opportunity to be here today.

I am Richard E. Cecconi. I retired 3-31-86 as superintendent, LTV Steel, 56-Inch Hot Strip Mill in Warren, OH. I retired after 30 years' service under the Republic Steel Salaried Pension Plan.

The employees of LTV, both active and retired, believe that LTV, before this merger with Republic was signed, had studied the cost of this merger from every aspect and concluded that the cost was very attractive indeed if you took the combined companies, trimmed about one-third of the employees, and reduced the value of the pension obligations to near zero.

Pension plan funding depends on the priority given it by the company chief executive officer. It has almost nothing to do with the financial health of a company. Honest, competent management funds pension plans even when it is a hardship. Greedy, incompetent management will allow pension plans to go unfunded as long as the law allows. It is as simple as that, and we should not try to make it difficult. It is not complicated.

Not one company has ever gone bankrupt because of having funded their pension plans. At the same time pension plans go unfunded, the electric bills get paid, the gas bills get paid, the country club dues get paid, and the chief executive officers get bonuses.

A pension is earned, and the only difference between a paycheck and a pension check is that you get your pension check at the end of a career.

LTV management in February 1987, 1 month ago, paid themselves a performance bonus for the year 1986. The bonus was substantially more than paid in the previous 2 years—a performance bonus for 1986, a year when they received concessions from employees, filed bankruptcy, stopped paying retiree benefits and monthly pension payments.

Fortune Magazine recently listed LTV as the least-admired company in America, and I have no idea how the hell they did not get the world title. [Laughter.]

During my 30-year career with Republic and LTV, I had several opportunities to work with other companies which offered higher salaries, but I was influenced to remain with Republic because Republic had so many times over the years stressed the high value and importance to my family of the salaried benefits package, including the pension plan, with lump sum provision. Republic had many times called this package a commitment to their employees.

Now that the pension plans have been terminated and taken over by PBGC, I must ask why does PBGC discriminate against retirees on the basis of age. My monthly pension from LTV was $2,309 a month. I collected this for three months before I got their "Dear John" letter.

On the basis of my age, 50, PBGC says I am an early retiree and pays me $632. There is a shortfall there of some $1,677.

Senator **Metzenbaum**. A month.

Mr. **Cecconi**. A month.

I worked 30 years under this plan, and I now get 27 percent of my promised pension. If I had started work at age 55 and worked only 10 years under this plan, PBGC would then pay me the maximum. There is no fairness here. I was not an early retiree; I worked the full 30 years necessary to qualify for a full pension, and now get only 27 percent.

This very conservative administration in Washington, teamed with conservative corporate America, having succeeded in rolling back the clock on the American standard of living, has now raised the curtain on their third act; they intend to take pensions away from working America.

Abuse follows power, and reform follows abuse, and it is time for reform. The LTV retirees demand it; working America demands it. The 1986 elections were the result of conservative abuse. America is beginning to lose patience.

Legislation restoring our pensions and benefits is the only way to make the statement the situation demands, and the PBGC age formula is discriminatory and must be changed.

In conclusion, Mr. Chairman, I would like to thank this distinguished Committee for their interest in this matter, and I thank you.

Senator **Metzenbaum**. Thank you, Mr. Cecconi.

[The prepared statement of Mr. Cecconi follows:]

TESTIMONY OF RICHARD E. CECCONI

BEFORE THE SENATE SUBCOMMITTEE ON LABOR

MARCH 24, 1987

I am Richard E. Cecconi. I retired on March 31, 1986 as Superintendent of LTV Steel's 56" Hot Strip Mill in Warren, Ohio. I retired after 30 years of service under the Republic Steel Salaried Pension Plan. At the time of my retirement I was among the top 400 managers of LTV Steel.

I am here today to share with you my thoughts and opinions on the failure of the LTV Pension Plans.

It is not only my opinion but the opinion of just about all active and retired employees of LTV with whom I have communications that the LTV bankruptcy and resulting pension plan terminations was not the result of a failed company, but rather was the result of very deliberate, calculated planning on the part of LTV Corporation. Not a failure but a success.

Pension Plan funding depends on the priority given it by the company C.E.O.. If the C.E.O. wants the pension plans of his company funded then they will be funded, simple as that. It has almost nothing to do with the financial health of the company. Not one company has ever gone bankrupt because of having funded their pension plans. Pension Plans go unfunded because the law allows it to happen. At the same time that pension plans go unfunded the electric bills get paid, the gas bills get paid and yes C.E.O.'s get bonuses. LTV never missed a year of giving bonuses.

Companies are allowed by law to reach back 30 to 40 years into the pockets of their retirees for monies that are then used in part to pay for company perks and bonuses.

LTV management in February 1987, paid themselves a performance bonus for the year 1986. The bonus amount was substantially more than paid the previous two years. A performance bonus for 1986, a year when they received concessions from employees, filed bankruptcy, and stopped paying retirement benefits and monthly pension payments.

There is nothing complicated about pension plan funding. Honest competent management funds pension plans even when it is a hardship. Greedy, incompetent management will allow pension plans to go unfunded as long as the law continues to allow it. Simple as that. Don't try to make it complicated.

Republic Steel had always funded their pension plans until 1983, the year they announced that they would merge with LTV'S J&L Steel. It was the general opinion of Republic managers that the plans went unfunded that year at the direction of LTV. LTV never funded the pension plans after the merger and they were finally terminated. LTV employees and retirees believe that LTV even before the merger was final LTV had made the decision to allow the pension plans to terminate, and the law allowed it to happen.

As pension creditors in bankruptcy court we now find ourselves on the bottom of the list of creditors and are told that we will have to compromise. Well I don't buy into that idea. Pensions are something we worked hard and long for and the way we lost them has filled us with outrage. LTV has the ability to pay and they must pay. That simple.

Looking back it is my opinion that LTV had planned to file bankruptcy between September and December 1986 before the economy began to heat up in preparation for the 1988 elections. When LTV got the word in mid July 1986 that USS was definitely going to be on strike for an extended time, LTV knew that they had to file bankruptcy immediately or they would lose the opportunity altogether because of the profits that would be generated as the result of a full order book. Take a look at the cash situation at LTV. If they had not filed bankruptcy in July 1986 they would not now be able to, and that did not fit into their plans.

I am told that legislation can not be retroactive to require LTV to pay pensions and benefits. I must ask why not? Retroactive legislation is not unheard of. LTV reached back into my pocket 30 years and took my earnings for themselves. What would Congress do if someone tried to take away their pensions? No, we will never agree to a compromise. A pension is no different than a paycheck except that you get paid at the end of a career rather than at the end of the month.

I also would like to know why PBGC discriminates against retirees on the basis of age? My monthly pension from LTV was $2309.56 but because of my age (50) PBGC says I am an early retiree and pays me only $632.33 per month. I worked 30 years under this plan and now receive only 27% of my pension. If I had started work at age 55 and worked only 10 years under the plan PBGC would then pay me the maximum. This isn't fair no matter how you look at it and should be changed retroactive. I was not an early retiree, I worked the full 30 years necessary to qualify for a full pension and now get only 27%. Put yourself in our place. Would you stand for it?

LTV was recently voted the Least Admired Company In America. I have no idea how they missed the world title.

Management that fails to pay pensions as the result of bankruptcy or any other reason should lose control of the company and should not collect any separation or golden parachute pay, and the law should be in very simple, direct language.

LTV Management has shown themselves to be greedy, arrogant, and ruthless. Early on in the merger, one Division President, in an open management meeting, made the statement that the only real new technology introduced into the steel industry in the last 20 years was intimidation, and he intended to use it. In another meeting about one year into the merger, LTV having detected much resistance to their management style, came right out and made the statement that the managers of LTV had a decision to make, they could get on the steamroller or they could get under the steamroller.

During my 30 year career with Republic and LTV I had several opportunities to work for other companies which offered higher salaries, but I was influenced to remain with Republic because Republic had so many times over the years stressed the high value and importance of the salaried benefits package including the pension plan with lump sum provisions. Republic even called it a commitment to their employees.

LTV cannot be allowed to back away from paying the earned pensions and other benefits which Republic promised, by pleading poverty while at the same time their high executives are living in fat city and giving themselves bonuses.

The ruthless hand of LTV has touched many and has left grief wherever it has touched. They tell so many lies that they no longer know what the truth is. I am sure LTV has made available documents that confirm what they want you to believe. You should not take any information they give you at face value. They are very good at making presentations that are exactly as they want them to be. I listened to them lie for two years. Their public relations and accounting departments will produce what they are told.

Conservative corporate America has saved something for the third act - they intend to take away pensions from Working America.

American workers have seen conservative corporate America abuse the power given them by the very conservative administration. Abuse follows power and reform follows abuse. It is time for reform, retroactive reform. America demands it. The 1986 elections were the result of conservative abuse. America is beginning to lose patience.

That's where we are, and if anyone cares to hear my thoughts on how we got here I could start with the 1980 elections and bring you up to date. The last 6 years have seen Working America brought to it's knees, all through a well orchestrated conservative effort.

Retroactive Legislation is the only way to make the statement that this situation demands.

The PBGC Age Formula is discriminatory and also must be changed retroactively.

Senators, you are only looking into this situation, we are living it.

Senator METZENBAUM. Mr. Knox?

Mr. KNOX. Thank you, sir.

I would like to thank Senator Metzenbaum and Congressman Clay for their letter to the bank.

I am Steve Knox, and I have been with Reeves Brothers for 10 years, and I am 31 years old. I have five children. I am fully vested in the Reeves Brothers pension plan.

I am here today because I feel that this is a highly immoral thing that these companies have been doing, and they are setting up a precedent of taking money that belongs to us. I disagree with the administration's proposal as far as whose money it belongs to. I believe it is our money. And I have brought with me today evidence of this, in a pension plan booklet, and it is a pension plan for hourly employees.

Inside this pension plan for employees, it says this, and I quote:

> The pension fund will increase through company contributions and gains on fund investments. Of course, the pension fund will also reflect any losses that may be incurred on investment of the fund and will be reduced by benefit payments.

This tells me that the capital gains will go back to the employees. I believe that it is highly immoral, even deceptive, and I would go almost as far as to say fraudulent, to tell people who are beginning an employment relationship with Reeves Brothers that they will soon telescope into a benefit package program that will grow and grow over the years. And we have currently people who are under a $61 a month retirement. Now, this is not adequate. I believe also that this is deferred wages. This is not a company bonus, this is not a gift, but this is deferred wages which we have earned. If I put $200 in a trust fund for you, then it grows over the years to draw $800 interest. Do I have the right to come in and take your $800? I am saying to the company and saying to this committee that I believe that this is our money. I believe that when Schick made the covenant with the nine banks, that they did something that was illegal and immoral and inhumane, without regard to the human factor.

We are none of us statistics on a computer read-out, but we are human beings, who are going to have to have money for our utilities and for our food and other provisions in our old age. And eventually, if the Lord is willing, we will all be old one day, and I think it is time to take a look at it now. In 3 or 4 years, I do not believe Reeves Brothers will increase their pension adequately enough to even keep up with inflation, much less to keep up with the times. And I believe that we are going to have to do something to protect our people. We need legislation to protect these funds, and I believe we do need a definition that this is the employees' money.

I believe we have to put a strong statement in that without legislation, the companies are going to take our pensions—you are dangling something out there, and the sparkle gets in their eyes—and they see the advantage of taking companies over, and company rollovers, and leveraged buyouts. We did not profit by the buyout. We have not profited one bit by the buyout from Schick. But they are growing millions and millions of dollars richer.

In terminating these plans, I believe that we are going to have to somehow get hold of what really is right and true, because one day we are going to stand before God and have to give an answer for what we have done. And when you are in a high dollar bracket, it does not make any difference whether you have a real high income or not on your retirement. But when you are making an income that is just enough to get by on, just enough to pay the expenses and costs of living, then you have to have a retirement that you can count on and depend upon.

I thank you very much for the honor of speaking to this panel.

[The prepared statement of Mr. Knox follows:]

Testimony of Steve Knox, an employee of Reeves Brothers, Inc. and a member of the Amalgamated Clothing and Textile Workers Union Local 2500 before the Senate Subcommittee on Labor and the House Subcommitte on Labor Management Relations at the Joint Oversight Hearing on Overfunded and Underfunded Pension Plans

March 24, 1987

My name is Steve Knox and I work for Reeves Brothers Inc. in Cornelius, North Carolina. I am thirty-one years old and have worked at Reeves for twelve years. I am married and am a father of four children.

I am speaking to you today officially as a representative of my 750 brother and sister union members of the Amalgamated Clothing and Textile Workers Union at the two Cornelius plants of Reeves Brothers. But I also feel that I am representing all 7,000 Reeves employees throughout the United States. I am honored to be speaking to such a distinguished panel about the concerns of these good Americans.

In April of 1986 my fellow workers in Cornelius and I voted to join the Amalgamated Clothing and Textile Workers Union in an election conducted by the National Labor Relations Board. In May of that same year our company was sold to Schick, Inc. of Darien, Connecticut. Part of the agreement that allowed Schick to buy Reeves included a one hundred million dollar loan from nine banks. National Westminster Bank, USA was the lead bank and the entire buy-out was organized by Drexel Burnham Lambert which is, as I'm sure you are aware, currently under government investigation.

We believed that nothing really was changed by this buy-out; but we were wrong. The loan agreement has a clause in it where Schick and Reeves have agreed to terminate our pensions and give any surplus funding to the banks. We feel this is very unfair. We believe that the pension surplus belongs to all of the workers of Reeves Brothers, whose hard work created the company's ability to make contributions in the first place. You may say to yourselves what is the big deal? The Reeves employees will still have a pension and the excess money will rescue a company in desperate financial shape--but your assumptions would be wrong. Reeves and Schick are very healthy companies that have had excellent profits over the years. This termination, if allowed, represents the banks and our company getting together to steal our retirement security, at great cost to us but of little benefit to big multi-million and billion dollar banks. Today the average retirement benefit for hourly employees is only $61. No person could possibly live on this amount. But I feel the issue goes beyond just the relationship between some banks and our company.

When I came to Reeves brothers a long time ago I read in our pension booklet that the pension plan was set up for us, the workers at Reeves. We were told and we believed that as the pension fund grew larger we would benefit from this growth when we retired. We thought we would get more money, we never thought that the extra cushion would be used to pay off any debts but our own! Now our pension plan is about to be raided. Our hard earned money is being taken away from us. Not because the company will go bankrupt if it doesn't get it, but just because it wants the money which happens to be handy. We turn to you our representatives, for justice. We really need your help. Times are hard for a lot of people in this country right now. We expect that our retirements may also be hard. But you can help us by stopping the type of abuses that I have just described. Thank you for your help.

Senator **Metzenbaum**. The co-chairmen of this hearing are going to institute a new rule, and that is we are going to limit ourselves, including the co-chairmen, to 1 minute apiece, because otherwise we will be here until 4 o'clock in the afternoon. So I will limit myself to 1 minute.

Mr. Cecconi, how do you feel about the fact that the corporate executives participated in a decision to increase the retirement benefits for those who took lump sum retirements and then one of them took out $1.2 million for himself, and others also took out very substantial funds, leaving the funds almost depleted?

Mr. **Cecconi**. I am not at all happy about that. You know, if you are going to change a plan in that manner, then you should provide funds for it. If you provide funds for it, it is above-board and fine. If you do not provide funds for it, it amounts to robbery.

LTV knew all of that going in, and they knew what their obligation would be. And I am sure they provided for that, too.

Senator **Metzenbaum**. Mr. Knox, how much is the average retirement benefit now at your plant?

Mr. **Knox**. Approximately $61 a month.

Senator **Metzenbaum**. Sixty-one dollars a month. And that is the fund that Schick took $20 million out of when they took the company over?

Mr. **Knox**. To my knowledge, that is right, sir.

Senator **Metzenbaum**. Thank you.

Mr. Ballas, your benefit was how much, originally?

Mr. **Ballas**. One thousand sixty-seven dollars.

Senator **Metzenbaum**. And how much is it now?

Mr. **Ballas**. Five hundred.

Senator **Metzenbaum**. Five hundred. Thank you.

Congressman Clay.

Mr. **Clay**. Thank you.

Mr. Knox, when did you find out that the plan was underfunded; I assume you found out at the same time as other employees?

Mr. **Knox**. We had been in union negotiations since May, and during that time the company, Schick, had signed the covenant with the nine banks. And upon questioning the company in negotiations about this matter, they played ignorant, or maybe they were not playing, but they just told us very little to nothing, and it came out through the research of the union through public documents.

Mr. **Clay**. Thank you.

Senator **Metzenbaum**. Senator Harkin?

Senator **Harkin**. I have no questions, Mr. Chairman.

Senator **Metzenbaum**. I am just going to go down the line here, even though it is not in order.

Congressman Sawyer?

Mr. **Sawyer**. Mr. Cecconi, how far ahead of time were you aware of the condition of your pension plan?

Mr. **Cecconi**. When I retired on 3-31, the benefits officer went over the plan with myself and my wife and told me that my plan, my pension, would be guaranteed for my lifetime, that I was fully vested and the plan was guaranteed. I now found out what that guarantee means; it means very little.

I found out I was broke the day they sent me the letter.

Mr. **Sawyer**. After the fact, far after the fact.

Mr. CECCONI. Yes. As a matter of fact, after PBGC took over in October, on October 23rd or whatever—I have it in my briefcase—I received the year-end statement from LTV, telling me that in 1985 the plan met minimum funding. And it is already terminated—after it was terminated, I received a document—I have it in here, and I would be happy to give it to you—telling me the plan met minimum funding.

Mr. SAWYER. Thank you.

Senator METZENBAUM. Mr. Jontz?

Mr. JONTZ. Mr. Chairman, I would be glad to take my minute to offer a motion to bestow upon LTV "the least admired company in the world" title, if it would be in order. [Laughter.]

I have no questions. I just want to add that there are a great many LTV retirees in Indiana and also former employees of the Continental Steel Company in Kokomo, IN who would have testimony very similar to what we have heard here today that would emphasize and repeat what we have heard.

Senator METZENBAUM. You are absolutely right.

Congressman Owens?

Mr. OWENS. Just one question of Mr. Ballas. You lost $400 right away. It is not clear to me how that happened. Was that an individual negotiation with you, or was it as a result of the negotiation of the union with the company for a broad range of employees?

Mr. BALLAS. It was an agreement for me to retire providing the employees that were remaining would expand their duties. In that way, they gave us the $400 to get rid of the older employees, to reduce the number of employees that they have in that plant. But that did not have anything to do with a contract. As long as that plant was working, we had an agreement with them that we should be getting our $400, because we gave up our jobs for that very thing.

Now they are trying to sweep it right under with the chapter 11.

Mr. OWENS. But you say you lost the $400 right away?

Mr. BALLAS. No. It has been 3 months now.

Senator METZENBAUM. Isn't it a fact that the PBGC just does not guarantee that $400?

Mr. BALLAS. Right, that is right.

Senator METZENBAUM. And that is the way you lost it.

Mr. BALLAS. Yes.

Mr. OWENS. Thank you.

Senator METZENBAUM. I want to thank this panel very much. And I do not mean to be short with them, but unfortunately the time is running out on us. Thank you for your cooperation and thank you, Paul Walters, for joining Mr. Cecconi and being down here with us today. It is nice to have you with us.

Our next panel consists of John Rother, director of legislation, research and public policy, the American Association of Retired Persons in Washington, DC, and Dorothy Ryan, a long-time friend of the Chairman and president of the Ohio State Council of Senior Citizens of Youngstown, speaking on behalf of the National Council of Senior Citizens.

I think both of you have heard the chair's request, and that is we will give you notice when 3 minutes is up and have to cut you off at the end of 4 minutes.

Mr. Rother?

STATEMENTS OF JOHN ROTHER, DIRECTOR OF LEGISLATION, RESEARCH AND PUBLIC POLICY, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC, AND DOROTHY RYAN, PRESIDENT, OHIO STATE COUNCIL OF SENIOR CITIZENS, YOUNGSTOWN, OH, ON BEHALF OF NATIONAL COUNCIL OF SENIOR CITIZENS

Mr. **Rother**. Thank you, Mr. Chairman.

We prepared extensive testimony, which I ask be made a part of the record at this point.

Senator **Metzenbaum**. Your entire statement will be included in the record, and we apologize to you for not having the luxury of more time, but I think the clock ran out on the Secretary of Labor and we, frankly, were not that prepared to cut him off too shortly.

Mr. **Rother**. Mr. Chairman, members of the Committee, my name is John Rother. I am here representing the American Association of Retired Persons, AARP. We have now over 25 million members over the age of 50, and of course, we have long been concerned with the fairness, security and adequacy of the private pension system.

We do commend the administration for making a serious attempt to address the problems of pension overfunding and underfunding. The administration's proposal constitutes a solid conceptual foundation for needed legislation in this area. However, we believe that the administration's proposal is inadequate in several respects.

There are certain principles which provide a framework for changes in pension law related to terminations and reversions, and I would briefly like to mention three principles that could guide our efforts to institute reform.

First, plan participants, workers and retirees, have an equitable interest in the assets built up in the plan. In other words, at least part of the so-called surplus belongs to the plan participants.

Second, allowing withdrawals from ongoing plans makes sense only as a disincentive to plan terminations. Therefore, terminations must always be less attractive than withdrawals.

And third, if withdrawals are permitted, there must be a cushion above full funding levels to guard against asset fluctuation and to allow for benefit improvements.

Unfortunately, we find that the administration proposal fails to fully satisfy these principles. This plan does not recognize the equitable interest of plan participants. In fact it is based on the idea that all of the assets belong to the employer.

While the proposal allows withdrawals—a radical departure from current law—it does not sufficiently discourage terminations. Many plan sponsors will find that they can get greater amounts if they terminate a plan than if they take a withdrawal.

Chart 1 graphically illustrates this point. On the left is the amount above the termination liability and how it would be distributed. This chart assumes a 100 percent surplus above termination liability. You can see that the amount an employer would receive from a termination would be quite a bit greater than from a withdrawal.

Finally, the cushion required in the administration plan is not sufficient. It does not fully protect the benefit security of plan participants. So AARP recommends that any proposal to allow withdrawals must have the following two elements. On withdrawal, the cushion left in the plan should be an additional 10 percent above the administration's proposal. This cushion will remain in the plan to protect against investment fluctuations and to leave open the possibility of future benefit improvements.

Second, on termination, the cushion amount would be paid out as benefit enhancements to plan participants, workers and retirees. In addition, a 20 percent excise tax would be imposed on any reversion amount. This combination makes terminations much less attractive, and recognizes participants 'equitable interest.

The second chart illustrates our proposed recommendations to these committees.

Finally, I would like to say that we must approach any departure from the traditional ERISA exclusive benefit rule with great caution. Any change must ensure greater protection for plan participants and greater security for the pension system as a whole.

The wave of terminations and reversions which has taken place in this decade threatens to undermine confidence in the private pension system. We believe the time has come for responsible legislative remedies to make good the promise of ERISA that when a pension is promised, it will be there when needed. We pledge our efforts, working with you, Mr. Chairman and with the House Committee, to assure that this is achieved this year.

Thank you.

Senator METZENBAUM. Thank you very much, Mr. Rother. You charts are very illuminating and very helpful, and they will be included in the record. We do look forward to working with the AARP.

[The prepared statement of Mr. Rother, with an attachment, follows:]

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before a joint hearing on

OVERFUNDED AND UNDERFUNDED PENSION PLANS

held by the

SENATE SUBCOMMITTEE ON LABOR

and the

HOUSE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

March 24, 1987

Presented by:
John C. Rother,
Director, Legislation, Research
 and Public Policy
American Association of Retired Persons

The American Association of Retired Persons (AARP) is the nation's largest membership organization, representing the interests of 25 million members age 50 and above. The Association is pleased to testify today on the Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans (hereafter the Proposal).

AARP commends the Administration for its efforts to address the problems of overfunding and underfunding in pension plans. The Proposal is a responsible attempt to deal with problems that threaten retirement benefit security. Nevertheless, the Association believes modifications are necessary to ensure a solution more consistent with good pension policy.

I. PRIVATE PENSIONS STILL NOT SECURE

The ultimate goal of changes in the income support structure serving retired Americans must be the establishment of a minimum standard of living for all older persons and a reasonable guarantee of adequacy, stability and security of retirement income so that individuals can plan for economic security in their later years. To be adequate, a retired person's income should be sufficient to prevent a significant decline in the living standard achieved earlier in life. Social Security is the basic foundation for retirement income planning. But to achieve the adequacy goal, Social Security must be supplemented by income from other sources, particularly private pensions, employment, savings and other income-producing assets.

The private pension system has grown dramatically over the past generation, but it must continue to expand in order to better meet the retirement income needs of older Americans. While the Employee Retirement Income Security Act of 1974 (ERISA) stands as the watershed of pension benefit security, recent events have pointed to deficiencies in the law that could severely undermine the security of the pension promise.

II. THE PROBLEM

The first disturbing trend has been the recent wave of pension plan terminations for the purpose of recovering so-called "excess" assets. While terminations for reversions were rare before 1980, since that time, well over $10 billion covering over 1 million plan participants have reverted to employers. The tremendous stock market boom, along with other economic factors, has currently raised pension assets to about $200 billion more than is presently required by the ERISA minimum funding standard, thus creating a tempting pot of money that threatens the stability and integrity of the private pension system.

A second problem is the recent trend in terminations of several large, significantly underfunded defined benefit pension plans. Neither the employer, nor the Pension Benefit Guarantee Corporation (PBGC) is currently liable for all unfunded benefits; thus, many plan participants have not received their full promised benefits. These terminations have also increased the strain on the financially troubled PBGC, which generally assumes terminated underfunded plan liabilities.

III. PRINCIPLES FOR REMEDIAL LEGISLATION

In order to correct these weaknesses, the Administration has proposed a broad and interwoven solution to the problems of overfunding and underfunding. Comprehensive in scope, the proposal also embodies a radical departure from ERISA's current rules, particularly the "exclusive benefit" rule. To determine whether a departure of this kind is both an effective solution and consistent with basic tenets of private pension law, this proposal must be considered against the following principles, which AARP puts forth as a framework for remedial legislation:

1. "Equitable interest" - Part of the assets built up in a pension plan, established with tax incentives in order to promote adequate retirement income, belongs to plan participants.

2. Funds in any pension plan have been put there for the "exclusive benefit" of that plan's participants, and the security and integrity of that plan must be foremost protected.

3. A "withdrawal" of pension fund assets makes sense only as a less onerous alternative to plan termination; therefore, terminations should be discouraged and always made less attractive than withdrawals.

4. In any withdrawal, a plan should be left fully funded, and must also include an added "cushion" to guard against asset fluctuation and to promote benefit enhancement.

5. Pension law should encourage present and future benefit security, including plan continuity, adequate funding, and benefit enhancement.

IV. ADMINISTRATION PROPOSAL- ACCESS TO PLAN FUNDS

a. Reasons for Change

The Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans (Proposal) correctly identifies the problems of current law under the Asset Reversion Implementation Guidelines (Guidelines). The Guidelines, instead of slowing the trend of terminations for reversions, formally allowed such practices as "termination/reestablishments" and "spinoff terminations." In both these transactions, a remaining or reestablished plan is generally stripped of any assets above the plan's termination liability. There are no restrictions on employer use of these recaptured assets. The net result has been to encourage terminations.

The Proposal squarely recognizes that change is needed because the reserve of assets above the plan's termination liability-- any "cushion" -- is eliminated. The Proposal is completely on point when it reasons: "The absence of this cushion reduces participants' benefit security with respect to future benefit accruals and may also discourage employers from granting ad hoc benefit increases or cost of living allowances for retirees." (Proposal, pg 5).

The Proposal also correctly reasons that it is poor policy to allow an employer who has both well-funded and underfunded plans to benefit from reversions from tax-favored retirement funds while other plans of that employer remain underfunded. Current law does not require that the remaining plans of the employer recapturing assets be adequately funded.

b. Proposed Change

The Proposal would allow a radical alternative in its attempt to resolve the problem of terminations for reversions. To halt outright terminations, the Proposal sets forth a "withdrawal" option. An employer would be permitted to withdraw assets from an ongoing plan if the following conditions are met:

- the plan is maintained at the new "minimum benefit security level" (the so called "cushion")
- all other plans of the employer, in the aggregate, exceed the "minimum benefit security level"

The "minimum benefit security level" -- the "cushion" -- would equal the greater of:

- 125 percent of the termination liability

OR

- the "full funding amount" of the plan (the point at which the minimum funding rules require no additional contributions for the year)

However, the Proposal would permit a substantially reduced cushion for any annuitized benefits.

The Proposal would continue to allow terminations, but would limit the amount an employer may recover to the "permissible reversion amount":

- If the employer continues to sponsor other underfunded defined benefits plans, the permissible reversion amount would equal the same as for a withdrawal (that is, amounts above the cushion), but the cushion itself would be allocated to the remaining defined benefit plans.

- If the employer has no other defined benefit plans, or other adequately funded plans, the permissible reversion amount would be all assets over termination liability (the entire cushion). Thus, a termination in this instance would allow the same reversion as current law.

- The only disincentive added is that an employer leaving the defined benefit system entirely would be precluded from establishing a defined benefit plan for those employees for five years (the so-called "5-year curse").

V. **ANALYSIS-ACCESS TO PLAN FUNDS**

ERISA was adopted at a time of concern for plan underfunding, while the current trend of overfunding in plans is the result of a unique set of economic events (stock market, bond market, interest rates). This is illustrated by the fact that before 1981, such terminations for reversions were rare (only $18 million in 1980), while now, they have become a part of corporate boardroom strategy (over $10 billion since 1980). While the trend is new, and may only last a short time, it is clearly capable of repetition, and must be curtailed in order to protect plan security and the integrity of the pension system. In order to curb this abuse, the law can either: (1) prohibit terminations for reversions, (2) encourage withdrawals and/or (3) discourage terminations for reversions.

a. Withdrawal Option

The first question that must be answered is whether a "withdrawal" option is warranted. Current ERISA law, as well as general trust law, clearly prohibits a sponsor from withdrawing money from a plan that is intended for the "exclusive benefit" of others.

The only reason for a departure from this basic principle would be to correct a flaw in the current system. Such a flaw exists since current law, which is premised upon maintaining the voluntary nature of the private pension system, gives all employers the option to terminate a pension plan and recapture assets above termination liability. Under current law, not only does the employer receive the benefit of a plan windfall, but the employee suffers the adverse effect upon termination of the loss of the benefits of plan continuity. (For further information, see the attached study, "The Impact of 'Overfunded' Pension Terminations on Workers.")

Current law is thus clearly inadequate. Since a prohibition of plan termination is inconsistent with the voluntary nature of the pension system, a withdrawal option must be considered.

The second question then becomes what type of withdrawal is appropriate. Returning to the principles set forth above, any withdrawal must recognize that:

1. part of the assets in the fund belong to participants;
2. it is only appropriate as a disincentive to termination; and
3. a fully funded plan, with an adequate cushion, should be maintained.

While recognizing some of the basic problems of withdrawals, the Administration Proposal does not go far enough in adhering to these principles.

First, there is no acknowledgment that any of the funds in pension plans, or any of the return on the equity of the plans, belongs in some part to plan participants. In fact, the very basis of the Proposal's withdrawal and termination options is just the opposite: that despite the tax incentive, and despite the "exclusive benefit" rule, pension plan money belongs to the employer. Thus, there is insufficient recognition of the "equitable interest" of plan participants in assets accumulated in the plan.

Second, the withdrawal option under the Proposal is not necessarily a disincentive to termination. In many instances, the amounts to be recaptured in a withdrawal are nearly equal to that of a termination. Worse yet, the employer may still be able to recapture more assets in some terminations than in the withdrawal option. This is true where the employer has only one plan or other plans are adequately funded. Since the withdrawal option does not always discourage terminations, in many instances it will serve only as a legitimate sanction to withdraw assets without serving any useful disincentive function. Stronger disincentives to termination than those embodied in the Proposal are needed.

Third, the Proposal does not leave a sufficient cushion to adequately protect the original plan participants. First and foremost, the participants of the plan from which money is withdrawn must be fully protected. Because the withdrawal option is so radical a departure from basic pension law, we should, if anything, err on the side of benefit security. Because each plan embodies a different set of employees, and often a different set of promised benefits, it is essential that the employer's promised benefits are not compromised. The Proposal suggests a cushion equal to the greater of 125 percent of termination liability (an arbitrary approximation) or the full funding amount of the plan (generally higher). The full funding amount is a superior starting point, since on a plan specific basis that amount is based on both earned benefits and projected benefits of an ongoing plan. However, the full funding amount does not completely recognize the needs of that plan's participants. In addition to the full funding amount for active participants, an appropriate cushion should incorporate two other factors:

- the need to guard against asset fluctuation, and
- the need to maintain assets to enhance benefit security, including benefit improvements and ad hoc retiree adjustments.

The Proposal would permit a substantial reduction in the cushion amount if the benefits are annuitized. The cost of annuitizing benefits is a major factor in determining excess asset amounts. When interest rates are high, and the cost of an annuity is inexpensive, less assets are needed to cover plan liability. The result is that the low cost of annuitization may fuel the increase in assets. To reward standard industry practice in the event of withdrawals (or terminations) by also allowing a lesser cushion is inconsistent with the need to maintain an adequate cushion for future benefit security. Shifting of retirement income security from well-funded pension plans to individual annuities should not be encouraged. In addition, withdrawals themselves should be limited by requiring a larger cushion amount.

The "controlled group" concept for determining whether a withdrawal will be permitted will generally increase the cushion and therefore improve benefit security. The aggregation requirement for withdrawals will also prevent an employer with largely underfunded plans from recapturing assets from any overfunded plans. In instances where there is one plan (or other adequately funded plans), however, the controlled group concept will not increase the protective cushion, and additional amounts above the full funding amount are more essential. Even in the controlled group concept, the benefit security of the original plan is compromised when there is no recognition of the benefit promises made by that plan (often different from the promises made by other plans) to that set of employees. Leaving the original plan with only the full funding amount denies that any special relationship exists between the employer-sponsored plan and that plan's participants. In effect, the "exclusive benefit" rule is washed away, and future benefit security and benefit expectation for that plan's participants is jeopardized.

b. Termination Option

The third question, assuming an acceptable withdrawal option and cushion, is what type of termination recapture is appropriate. While the Administration's proposed withdrawal option is based on a conceptually workable set of principles, the termination option as proposed is inadequate. Again, returning to our principles, any termination must recognize that:

1. part of the assets in the fund belong to plan participants;
2. the "exclusive benefit" of that plan's funds must be primarily maintained for those participants' benefit security; and
3. the termination itself must be strongly discouraged.

First, there is again no acknowledgment that any of the pension plan money belongs to plan participants. While the withdrawal option at least recognizes that a cushion must be left for benefit security and benefit enhancement, the termination option completely ignores the concept that plan funds above termination liability belong to the participants of the terminated plan. Two basic facts are disregarded in determining how to divide assets in a termination: pension contributions are part of the entire salary package, and a tax advantage has been conferred for the purpose of benefitting those participants in the plan. This disregard for the participants' equitable share is especially true where an employer leaves the defined benefit system, in which case the recaptured amount will be the same as current law.

Thus, no solution or deterrent is even offered to remedy a recognized problem.

Second, the Administration's Proposal would ignore the "exclusive benefit" rule entirely in a termination and require the terminated plan to transfer assets above the termination liability to other underfunded plans. This would effectively give the employer the same reversion amount as under a withdrawal, but at the same time disregard the future benefit security of the terminated plan's participants. The proper funding of other employer plans, already an obligation of the employer, would be addressed by taking assets from a plan where benefits were promised to a different set of employees. The employer, by dipping into this newly-formed pension pool, can gain a windfall through a reversion from one plan, relieve an already existing obligation to another plan, and leave the participants of the first plan with less benefit security, even if a new plan is established. The simple result is that the participants in the terminated plan--who have believed they were in a plan that was ongoing, well-funded, and a source of future benefit security -- may now be worse off. Participants are hurt because their plan did better than expected in the short term snapshot view based on termination liability.

This transfer of assets again ignores any return on equity for participants of the terminated plan, and does not recognize the primacy of the future benefit security of that plan's participants. In fact, assets may be transferred to plans that have much higher benefit promises, and therefore greater liability, at the expense of participants of a plan in which money was originally intended for their exclusive benefit.

Third, the Proposal does not create sufficient disincentives to plan termination for reversion. Pension law should encourage both the formation of pension plans and the benefit security of those plans in existence as well. By maintaining termination as a comparable option to withdrawal, or in some instances an even better option as a means to recapture funds, the Proposal fails to solve the very problem this Proposal should address -- the termination of pension funds merely to recapture assets. Since a withdrawal option is created to allow employer access to plan funds, the termination option should be used only by plans that wish to terminate for reasons other than the recapture of assets. Therefore, recaptured amounts should always be less in a termination than a withdrawal, and penalties upon termination should be higher.

VI. AARP RECOMMENDATIONS- ACCESS TO PLAN FUNDS

Based on the framework established by the Administration Proposal, and guided by the set of principles already discussed, AARP recommends the following modifications to the withdrawal and termination options.

a. Withdrawal Option

In our view, the law should recognize that part of the assets in the fund belong to plan participants. In order to provide adequate protection against asset fluctuation, and to maintain assets needed for benefit enhancement, an increase in the minimum benefit security level (the "cushion") beyond the "full funding amount" is needed.

AARP recommends a 10 percent increase in a withdrawal cushion to the greater of:

- 135 percent of termination liability

OR

- 110 percent of the "full funding amount"

The plan aggregation rule would continue to be used to determine withdrawal availability. However, a reduction in the cushion would not be allowed for annuitized benefits. Annuitization is often part of the reason for the large surplus (due to low cost from high interest rates), and should not be used as a further incentive to lower the cushion. The 10 percent excise tax would also be maintained.

b. Termination Option

In our view, the law should recognize that part of the assets accumulated in the plan represent a return on equity and that the integrity of the plan -- whose purpose is the exclusive benefit of that plan's participants -- must be maintained. In addition, the termination itself should be discouraged.

AARP recommends that, in a termination:

- assets required to remain in the plan in a withdrawal (the cushion) be paid out to plan participants
- a 20 percent excise tax be imposed on the reversion amount

While plan aggregation is good policy in determining withdrawal availability, there are less compelling reasons in a termination. Mandated asset transfers between plans runs counter to the exclusive benefit rule. AARP is mindful of the problem of underfunded plans, but mandated asset transfers between plans undermines a basic ERISA protection and may raise more problems than it may solve. (For example, what is the proper fund transfer where plans have widely varied levels of promised benefits). A two-step approach, in which employers are required to fund-up any plan in a controlled group before taking a reversion, should be explored. Special rules involving the transfer of plan sponsorship beyond the controlled group will also need to be developed.

A 20 percent excise tax is recommended in order to further discourage terminations as compared to withdrawals. In addition, consideration should be given to earmarking part of the excise tax to the Pension Benefit Guarantee Corporation (PBGC).

Further, AARP questions the need for a "5 year curse," fearing that employees may be hurt by such a prohibition. If a moratorium on new defined benefit plan establishment is necessary to prevent abuse, a shorter period may suffice.

c. Transfers to Other Plans

In part, the Proposal mandates asset transfers in some instances, while allowing excise tax forgiveness for other transfers, particularly transfers to retiree health plans. The Association believes the problem of unfunded retiree health benefits is a major problem that requires a comprehensive solution. In this regard, this Proposal should in no way be seen as remedy for the large unfunded liabilities of retiree health plans. Further, AARP believes it inappropriate to permit pension plan funds to be used for other welfare plans such as retiree health plans before basic retirement income needs are met.

Therefore, AARP proposes, as a general guideline, the following hierarchy for the division of any remaining plan assets:

1. the security of the participants of the original pension plan;
2. the security of the participants of other pension plans of the employer;
3. the security of participants of retiree health plans of the employer; and
4. the reversion to the employer, with the appropriate excise tax.

VII. ADMINISTRATION PROPOSAL - MINIMUM FUNDING

a. Reasons for Change

The Administration Proposal also includes substantial changes in the minimum funding standards for pension plans. Change is needed because current law does not fully insure that plans will have sufficient assets to pay participants' benefits. As a result, unfunded liabilities have in many cases threatened the benefit security of plan participants as well as increased the financial strain on the PBGC.

b. Proposed Change - Underfunded Plans

The Proposal would, for underfunded plans, generally shorten the amortization period for existing unfunded accrued liabilities, benefit increases, experience losses, and funding waivers. The new amortization period will generally be determined by looking at the funding status of the plan and the maturity of the plan's liabilities. (Details on assumptions and methods are not yet developed).

The Proposal would also require a minimum contribution -- the cash flow rule -- equal to the total distributions paid by the plan during the year.

c. Proposed Change - All Plans

The Proposal would also require all plans to comply with certain changes. Specifically, liability for contributions would fall on the controlled group, the timing of contributions would be increased, minimum funding waivers would be restricted, deduction limits would be revised, and employer liability would extend beyond benefit commitments to termination liability.

VIII. ANALYSIS-MINIMUM FUNDING

As recent events have demonstrated, and the PBGC's increased deficit proves, the minimum funding rules need to be strengthened. The question is whether the proposed solution goes beyond the scope of the problem. Since details are not fully available, AARP notes some potentially troublesome questions.

The biggest problem area may be that of plans currently in trouble. To the extent plans are now underfunded and therefore unable to absorb the change to a shorter amortization period, stiffer funding rules may force these plans over the edge. Appropriate transition rules will need to be developed to safeguard these plans.

Second, since the new rules require much stricter funding, the establishment of new defined benefit plans may be severely hampered. This is especially true where new plans attempt to provide credit for past service. To the extent such liabilities prove too great under the new funding method, past service credit may not be feasible. This results in a disincentive to more comprehensive plan coverage. For similar reasons, any type of benefit enhancement, for both new and old plans, may be unnecessarily discouraged. Funding rules should not be so strict that the costs of benefit improvements become unreasonable.

A third problem left unresolved is that of actuarial reasonableness in plan assumptions. As long as plans are free to use wide parameters of reasonableness, there will be great variation in plan funding, and continued opportunity for abuse.

The Proposal does set forth several changes that AARP can support. If underfunded plans are still small in number, and confined to certain sectors of the economy, then drastic changes may not be essential. Any solution to the underfunding problem should avoid overprotecting the PBGC at the expense of the private pension system. With this as a guideline, the following measures, for example, should promote benefit security without overburdening the pension system:

- the cash flow rule - a yearly minimum contribution equal to total yearly distributions should increase plan security;
- control group liability - all related employers should be liable for contributions required by the minimum funding standards for all plans maintained by the group;
- timing of contributions - while speeding payments up to a quarterly basis may not be needed, certainly requiring earlier payments, as well as an earlier final payment, will provide a quicker signal if adequate funding is a problem;
- restricting funding waivers - requiring that waivers be determined on a controlled group basis is consistent with insuring that a real and temporary hardship exists; in addition, notification to plan participants should always accompany plan action; and
- extension of employer liability - the employer should be liable for the full level of the plan's termination liability, including all fixed and contingent accrued benefits.

IX. CONCLUSION

AARP again commends the Administration for its comprehensive approach to the problems of overfunding and underfunding. The Association maintains, however, that the Proposal fails to sufficiently recognize that part of the assets above termination liability belong to plan participants. Because of this, the Proposal does not require an adequate cushion upon withdrawal, and fails to require a pay-out of assets upon termination. In any event, both withdrawals and terminations should be discouraged, with the strongest disincentives always attached to terminations.

Although a number of the minimum funding standards have been improved, AARP is concerned the proposed solution may be unnecessarily burdensome in some situations. Since details are still undeveloped, the Association simply cautions against overburdening an entire system to correct a more isolated problem.

AARP looks forward to continued work with both the Administration and these subcommittees to formulate a legislative solution. The problems have been identified and been given serious consideration by the Administration's Proposal. AARP believes that a more acceptable solution can be devised by building further upon the framework of this Proposal.

AARP

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before a joint hearing on

OVERFUNDED AND UNDERFUNDED PENSION PLANS

held by the

SENATE SUBCOMMITTEE ON LABOR

and the

HOUSE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

March 24, 1987

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) [illegible]
John T. Denning *President* Cyril F. Brickfield *Executive Director*

SUMMARY

The American Association of Retired Persons (AARP), representing the interests of 25 million members age 50 and above, is pleased to testify on the Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans (Proposal). AARP commends the Administration for its efforts to address the problems of overfunding and underfunding in pension plans. Nevertheless, the Association believes modifications are necessary to ensure a solution more consistent with good pension policy.

PRINCIPLES FOR REMEDIAL LEGISLATION

AARP believes that the Proposal must be considered from the perspective of the following principles which provide a framework for remedial legislation:

1. "Equitable interest" - Part of the assets built up in a pension plan, established with tax incentives in order to promote adequate retirement income, belongs to plan participants.

2. Funds in any pension plan have been put there for the "exclusive benefit" of that plan's participants, and the security and integrity of that plan must be protected.

3. A "withdrawal" of pension fund assets makes sense only as a less onerous alternative to plan termination; therefore, terminations should be discouraged and always made less attractive than withdrawals.

4. In any withdrawal, a plan should be left fully funded, and must also include an added "cushion" to guard against asset fluctuation and to promote benefit enhancement.

5. Pension law should encourage present and future benefit security, including plan continuity, adequate funding, and benefit enhancement.

AARP RECOMMENDATIONS

ACCESS TO PLAN FUNDS

a. Withdrawal Option

AARP recognizes that part of the assets in the fund belong to plan participants. In addition, in order to provide adequate protection against asset fluctuation, and to maintain assets needed for benefit enhancement, an increase in the minimum benefit security level (the "cushion") beyond the "full funding amount" is needed.

AARP recommends a 10 percent increase in a withdrawal cushion to the greater of:

- 135 percent of termination liability

OR

- 110 percent of the "full funding amount"

b. Termination Option

AARP recognizes that part of the assets accumulated in the plan represent a return on equity and that the integrity of the plan -- whose purpose is the exclusive benefit of that plan's participants -- must be maintained. In addition, the termination itself should be discouraged.

AARP recommends that, in a termination:

- assets required to remain in the plan in a withdrawal (the cushion) be paid out to plan participants; and
- a 20 percent excise tax be imposed on the reversion amount.

c. Transfers to Other Plans

AARP believes it inappropriate to permit pension plan funds to be used for other welfare plans, including retiree health plans, before basic retirement income needs are met. Therefore, AARP presents, as a general guideline, the following hierarchy for the division of any remaining plan assets:

1. the security of the participants of the original pension plan,
2. the security of the participants of other pension plans of the employer,
3. the security of participants of retiree health plans of the employer, and
4. the reversion to the employer, with the appropriate excise tax.

MINIMUM FUNDING

The minimum funding rules need to be strengthened. The question is whether the Proposal over-fixes the problem. Since details are not fully available, AARP notes some potentially troublesome questions. The biggest problem area may be for currently underfunded plans. Appropriate transition rules will need to be developed to safeguard those plans that are unable to absorb the change to a shorter amortization period.

Second, since the new rules require much stricter funding, the establishment of new defined benefit plans may be severely hampered. In addition, funding rules should not be so strict that the cost of benefit improvements becomes unreasonable.

A third problem left unresolved is that of actuarial reasonableness in plan assumptions. As long as plans are free to use wide parameters of reasonableness, there will be great variation in plan funding, and continued opportunity for abuse.

AARP believes that the following measures should promote benefit security without overburdening the pension system:

- the cash flow rule - a yearly minimum contribution equal to total yearly distributions should increase plan security;
- control group liability - all related employers should be liable for contributions required by the minimum funding standards for all plans maintained by the group;
- timing of contributions - while speeding payments up to a quarterly basis may not be needed, certainly requiring earlier payments, as well as an earlier final payment, will provide a quicker signal if adequate funding is a problem;
- restricting funding waivers - requiring that waivers be determined on a controlled group basis is consistent with insuring that a real and temporary hardship exists; in addition, notification to plan participants should always accompany plan action; and
- extension of employer liability - the employer should be liable for the full level of the plan's termination liability, including all fixed and contingent accrued benefits.

December 1986 #8602

THE IMPACT OF 'OVERFUNDED' PENSION TERMINATIONS ON WORKERS

by

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Research Summary

The Public Policy Institute was formed in 1985 as part of the Division of Legislation, Research and Public Policy of the American Association of Retired Persons. One of the missions of the Institute is to foster research and analysis on public policy issues of interest to older Americans. This paper presents part of that effort.

The views expressed herein are for information, debate and discussion, and do not necessarily represent formal policies of the Association.

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The Impact of 'Overfunded' Pension Terminations on Workers

In recent years there has been a rapid increase in the voluntary termination of "overfunded" defined benefit pension plans by plan sponsors. As of October 1986 over 1300 overfunded plans with over 1.5 million participants have been terminated or have requested approval for termination. The combined assets of these plans were over $33 billion, of which approximately $15 billion (46%) had been identified as "excess assets." It is estimated that about 4% of pension covered workers throughout the United States have been affected.

An overfunded pension plan is one where available funds are more than sufficient to meet liabilities accrued up to the point of termination (in contrast to projected future liabilities). When such plans are terminated, plan sponsors are required to purchase annuities to satisfy the liabilities that have accrued but may then "recapture" any excess assets that remain. These terminations are known as asset reversions.

Such terminations have been the subject of considerable controversy. The subject has been debated in several Congressional hearings, in testimony to a special asset reversion task force set up under the Labor Department's ERISA Advisory Council, in trade journals, and in the popular press. One outcome of the debate, instituted in the Tax Reform Act of 1986, has been the imposition of a 10% excise tax on amounts recaptured in terminations after December 31, 1985. Other changes to federal laws and regulations governing these terminations are currently being considered.

This research summary reports on the findings of a comprehensive study of asset reversion done for the American Association of Retired Persons by the Policy Center on Aging at Brandeis University.[*] The larger report from which this paper is drawn explains the concepts associated with overfunded terminations, summarises the broad spectrum of opinion that has been voiced, and presents a profile of the terminations that have occurred. In addition, the study reports on a telephone survey of terminated plan sponsors and presents findings from a computer analysis of the potential benefit losses that can result from the termination of pension plans.

Source of Surpluses

As stated above, overfunded pension plans are those in which funds on hand exceed those needed to satisfy liabilities accrued *at termination*. This does not necessarily imply that an overfunded plan has excess assets on a *continuing basis*, since plan sponsors usually fund to take account of future inflation and salary increases that will have an impact on benefits. Thus, a primary source of recoverable excess assets is the act of plan termination itself.

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[*] *Overfunded Pension Plan Terminations*. Waltham, MA: Policy Center on Aging, Heller School, 1986. For a copy of this report, contact the AARP Public Policy Institute, publication #86-03

Historically, another main factor creating excess assets, was the exceptionally high interest rates and massive stock market increases in recent years; investment returns generally exceeded the conservative assumptions used to fund plans. Also, during the recent period of high interest rates, annuities needed to satisfy termination liabilities were available at very favorable rates. These low cost annuities contributed to the size of fund surpluses.

Types of Terminations

There appear to be many reasons for terminations. One, of course, is the availability of excess funds that can be used for other corporate purposes. On the other hand, terminations have in some cases been non- discretionary, including those involving pension plans in companies going out of business or closing a plant or division. Other reasons given include (a) dissatisfaction with a plan, (b) the desire to change from a defined benefit to a defined contribution plan, and (c) the attempt to reduce a company's attractiveness to corporate raiders (because of the excess pension assets).

Overfunded terminations have been grouped into four main categories:

1. Terminations with no replacement plan;
2. Terminations with replacement by a defined contribution plan;
3. Termination/reestablishments; and
4. Spinoff/terminations.

The first two types are self-explanatory. Termination/reestablishments involve a replacement plan that is similar to or the same as the defined benefit plan that has been terminated. Since the replacement plan generally gives credit for past service under the terminated plan, the effect on benefits is generally minimal. There has been some conjecture, however, that these "lean" pension funds will be unable to support benefit improvements—such as postretirement inflation adjustments—in the future.

In spinoff/terminations, active plan participants continue to be covered by the same plan. Their plan is spun off from the original plan with sufficient assets to satisfy the termination liabilities. The original plan, which then contains only retired and separated vested participants (as well as all surplus assets), is then terminated. The effects of spinoffs are very similar to those in cases of reestablishment.

Profile of Overfunded Terminations

The trend toward overfunded plan terminations has moved forward rapidly during the decade of the eighties, in terms of both the number of terminations and the number of plan participants affected. In 1980 there were a mere 9 terminations where plan sponsors recaptured a million dollars or more. Since then, the number has risen annually and in some years spectacularly. In 1985 there was a total of 487 approved and pending terminations. During this same period, the annual total of plan participants affected has increased from 22,000 to over 600,000—a nearly 30-fold increase. And the surplus assets recaptured have grown from a little over $18 million in 1980 to over $6 billion in 1985!

Analysis of Pension Benefit Guaranty Corporation (PBGC) data indicates that there has been considerable diversity among terminating plans. Some generalizations are possible, however. The number of participants in most terminated plans has been small (56% with less than 500 employees). The amount of excess assets has also been comparatively small in many plans (75% with less than $5 million). However, the degree of overfunding (on a termination basis) has been substantial; plan sponsors recaptured over 40% of plan assets in more than two-thirds of terminations and over 60% in one-quarter of terminations.

The Telephone Survey

A key gap in the information available on plan terminations is the benefit formulas in terminating and successor defined benefit plans, as well as the employer contribution rates in defined contribution successor plans. An April, 1986 Hay-Huggins study commissioned by the Labor Department was a useful first step in collecting such data. Unfortunately, the data in this study concentrated on larger plans, where changes are less likely to be detrimental to plan participants than in smaller plans. In addition, there are no representative data in the Hay–Huggins study on the extent to which successor plans use pretermination service in calculating benefits.

To gather further information in this area, the Brandeis University Policy Center on Aging carried out a telephone survey of 150 large and small companies that had terminated overfunded pension plans. Unfortunately, there was a high degree of resistance on the part of plan sponsors to cooperating in the survey, indicating great corporate sensitivity on the issue. Nevertheless, at least two important findings emerged. First, among responding companies with new defined benefit plans (a category that contains approximately one third of overfunded terminations), successor plan formulas were usually the same as or similar to terminated plan formulas. Thus, the survey found little evidence of adverse impact on plan participants in such cases, except to the extent that the comparatively less well funded pension funds that remain may not be able to support future benefit increases for active workers and cost of living adjustments for retirees.

However, the survey indicated that there is significant potential for adverse impact on plan participants where the successor plan is a defined contribution plan. In particular, many defined contribution successor plans were profit sharing plans, which are usually not a source of predictable retirement income benefits.

Effects of Terminations on Workers

Attempts to assess the potential for termination benefit loss have been hampered by a lack of information—given the limitations of the Hay-Huggins, Brandeis, and other data collection efforts to date. Given this lack of data and the potential value of evaluating various termination scenarios, an analysis was carried out by the Policy Center on Aging of the potential for benefit loss in a wide variety of hypothetical situations. The use of hypothetical termination scenarios has two main advantages. First, it provides a wide range of models against which to judge the potential for benefit loss in actual terminations. Also, it permits a detailed analysis of what types of workers—in terms of age and years of service—are most affected by different types of terminations.

Benefit losses were calculated using a computer simulation model developed specifically for the study. Currently, as suggested above, there is little available evidence to suggest that accrual rates in post-termination defined benefit plans are less generous than in the plans they have replaced. The analysis focused, therefore, most attention on scenarios involving terminated defined *benefit* plans that are either not replaced or are replaced by a defined *contribution* plan. In recent years, roughly half of plan terminations were of this type.

The potential benefit loss resulting from terminations with no successor plan was examined for two common types of defined benefit formula, one which bases benefits on career average earnings and the other which bases benefits on the average of the highest five years of earnings. Selected findings are shown in Table 1.

Benefit loss was evaluated for workers in plans terminating in 1985. Assumed 1985 earnings were deflated by historical wage rate changes to simulate prior salary histories. Future salaries were calculated using an assumed 5 percent increase in wages, an increase that closely approximates average wage rate increases over the past two decades. Once the wage rate assumptions are made and the worker's years of service are chosen, the benefit loss as a percentage of the benefit that would have been paid is the same for any earnings level and any benefit accrual rate.

Percentage benefit losses for a younger worker are extremely large. *For a 30 year old worker with 10 years of service at the time of termination, losses are 92 percent in a career earnings plan and 96 percent in a final average earnings plans.* That is, this worker's vested 10-year pension would be much, much larger if he or she were able to continue working until age 65 under the plan.

The middle aged worker is also subject to significant benefit losses if a terminated plan is not replaced. Even with 20 years of service in a terminated plan, *a 45 year old worker in a plan with a career average formula loses 78 percent of the benefit.* In a plan with a final average earnings formula, where earnings at the end of a career are given increased weight, the loss would be 81 percent.

For the worker nearing retirement, participation in a terminated plan that is not replaced may have more negative consequences than for a younger worker. If a company liquidates or files for

Table 1
Potential Benefit Change:
Plan Termination with No Successor Plan*

Age at Termination	Years of Service at Termination	Terminated Plan Formula	Benefit Loss (% of age 65 benefit)
30	10	career average	92
30	10	final average**	96
45	20	career average	73
45	20	final average**	81
55	30	career average	46
55	30	final average**	52

* Based on simulation analysis.
** Average of highest 5 years of earnings.

Table 2
Potential Benefit Change:
Defined Contribution Successor Plan*

Terminated Plan Formula	Contribution Rate	Rate of Return On Assets	Age/Service at Termination	Benefit Change at Age 65
1.25% x years of service x final average earnings**	5%	5%	30/10	-59%
1.25% x years of service x final average earnings**	7%	9%	30/10	+8%
1.5% x years of service x career average earnings	7%	9%	60/30	-11%
1.5% x years of service x final average earnings**	5%	5%	60/30	-25%

* Based on simulation analysis.
** Average of highest 5 years of earnings.

bankruptcy and releases an older worker, the likelihood of becoming pension covered in another job is small—especially one with pension coverage. In view of this, the benefit losses for workers who have spent entire careers at a company terminating its plan are noteworthy. For the age 55 worker with 30 years of service who expects to work until age 65, a plan termination reduces expected years of service by 10 years or one quarter of the expected total. This one quarter reduction results in benefit losses of 46 percent (career average earnings plan) and 52 percent (final average earnings plan). Similarly, for an age 60 worker with 30 years of service, the years of plan coverage are shortened by 14 percent. The potential losses from this reduction are 27 percent (career average earnings plan) and 31 percent (final average earnings plan).

Even if a terminated plan participant immediately begins work for another company that has a plan with the same benefit formula, benefit losses are significant. The age 55 worker, for example, loses approximately one quarter of the benefit he would have received if the original plan had continued.

To assess benefit losses or gains from defined benefit to defined contribution termination scenarios, the study examined the effects under a wide variety of interest rate and contribution rate assumptions. Selected benefit changes are shown in Table 2. One of the clearest findings is that *defined contribution plans are most advantageous to workers who are young at the time of terminations, particularly when investment returns on contributed funds are high.* Looking at various scenarios, benefit gains occur only for those workers more than 20 years away from retirement and then only when very high investment returns are assumed. It is for these younger workers that the compounding effect of investment returns in defined contribution plans becomes so important.

Conversely, defined contribution successor plans are particularly damaging to those nearing retirement age at the time of a termination. In this case, contributions have only a short period to compound. Even under very generous assumptions, such workers experience a loss when moving to a defined contribution plan. For example, consider a worker who is age 60 with 30 years of service at the time of termination who (a) moves from a 1.5 percent of career average earnings plan, (b) to a 7 percent of earnings defined contribution plan, (c) which is projected to earn 9 percent per year interest. If this individual stays in the defined contribution plan until age 65, he would receive a combined benefit from the two plans that is 11 percent less than the benefit that would have accrued if the terminated plan had continued.

The effect on older workers is exaggerated if the terminated defined benefit plan calculates benefits based on final average earnings. Final average earnings formulas act as a preretirement inflation hedge. The value of a high five-year earnings measure, assuming a worker's earnings increase by 5 percent per year until retirement, increases 28 percent in the years between age 60 and age 65 and 63 percent in the years between age 55 and age 65. In addition, there is an effect from the increased years of service in the plan. For example, a person with 30 years of service at age 55 who plans to work until age 65 would have had an additional 10 years of service if the terminated plan had continued. This represents a 33 percent increase in the years of service measure. The 5 additional years of service for the age 60 worker represent a 17 percent increase in the years of service measure.

Combining the final average earnings and additional years of service effects, *the age 60 worker who has 30 years of service at plan termination loses out on a 50 percent increase in benefits in the 5 years before age 65. The age 55 worker foregoes a 117 percent increase* in pension benefits in 10 years. It is practically impossible for a defined contribution plan to make up these losses.

Issues

A wide range of opinion exists on overfunded terminations. Supporters have argued that the right to terminate is an important aspect of the voluntary private pension system. Without this right, the incentive to establish and adequately fund defined benefit plans would be diminished. They argue, therefore, that attempts to limit terminations actually endanger employees' retirement income security.

Defenders also contend that, for the most part, participants in terminated plans continue to be pension covered, often by plans that offer benefits equal or similar to those in terminated plans. The cases where coverage does not continue usually involve non-discretionary terminations in companies either going out of business or closing a plant or division. Given the continued coverage of most plan participants, they see no major reason why plan sponsors should not recover excess assets. Moreover, they believe the risk that plan sponsors undertake in order to provide specified benefit levels should be balanced by the ability to recoup surplus assets if fund performance is better than expected. If other mechanisms to recapture assets were available, termination would be much less frequently used. In their absence, however, it is argued that the ability to terminate should be retained.

Critics have disagreed with every one of these contentions. They argue that excess assets belong to plan participants rather than plan sponsors, since the contributions used to fund benefits are deferred wages. Moreover, terminations have actually reduced the benefit promise for many participants in terminated plans, particularly those without a replacement plan and those covered by a defined contribution replacement plan. Since such participants will not receive the benefits they contributed towards (through deferred wages), it is argued that they deserve a return of the surplus assets needed to fund the higher benefit promise.

Critics also contend that in cases where defined benefit coverage continues, some or all "surplus" assets are not really in excess of plan liabilities. They point out that after a termination, continuing and replacement plans are significantly underfunded on an ongoing basis. This post-termination underfunding suggests that spinoff and reestablishment terminations actually compromise the security of plan participants' benefits. In view of the rapid increase in the number of terminations and the precariousness of post-termination funding levels, they argue that a failure to legislate restrictions to termination laws will result in a significant loss of confidence in the pension system.

Policy Implications

The Brandeis study indicates that although many overfunded terminations to date have not resulted in immediate harm to plan participants, there still remains a significant potential for adverse effects. Some of these negative consequences are obvious, such as the reductions in expected pension income that occur when terminated pension plans are not replaced by other plans. Similarly, benefit losses will likely result from the replacement of terminated defined benefit plans by potentially less generous and less predictable defined contribution plans.

However, the potential for adverse effects also exists in what many observers view as the most benign terminations—that is, where terminated defined benefit plans are replaced by similar plans. On the one hand, there is the possibility that funds "trimmed down" by asset reversions may not be able to support future postretirement benefit improvements to the extent that plan sponsors have previously provided these adjustments. Thus, for example, retirees who are participants in terminated plans may be more susceptible to the adverse effects of inflation. Further, today's lower interest rates and the slower growth in stock market portfolios suggest that funds reduced to termination liability levels may be unable to maintain adequate funding levels in the future, particularly if companies experience economic difficulties. If this occurs, there is a potential for significant new burdens on the Pension Benefit Guaranty Corporation.

What is most clear for future policy development is that the data needed to fully evaluate the effects of terminations are lacking. The Brandeis study points out the need for timely and comprehensive data on terminated pension plans and, equally important, the need for information on the extent and nature of new plans created. In addition, studies on the trends in post-termination funding levels would be useful for future policy discussions.

Senator **METZENBAUM**. I am very happy to welcome my good friend Dorothy Ryan, who has been in the forefront of the battle for senior citizens' rights over many years.

Dorothy, please proceed.

Ms. **RYAN**. Thank you, Senator Metzenbaum. I am happy to see you again.

I am president of the Ohio State Council of Senior Citizens. My name is Dorothy Ryan, and our State Council is an affiliate of the National Council of Senior Citizens. Today I am testifying on behalf of the National Council.

I would like to thank Senator Metzenbaum and Congressman Clay for holding today's hearing on overfunded and underfunded pension plans. Most of these issues have reached crisis proportions and now threaten the economic security of hundreds of thousands of retirees.

With regard to overfunded pensions, NCSC strongly believes that pension plan assets represent the deferred wages of employees. As such we fundamentally oppose efforts to make it easier for companies to recover so-called excess assets from pension plans.

When defined benefit plans are terminated, there are often adverse economic consequences for workers and retirees covered by those plans. Furthermore, these trimmed down pension plans may become underfunded, and ultimately add further burden to the Pension Benefit Guaranty Corporation.

NCSC agrees with the administration that pension plan termination should be avoided, but we do not believe their proposal would be effective.

The 10 percent excise tax on asset reversion terminations should be doubled to 20 percent, and it would be reasonable to earmark half of such funds to support the PBGC. Any termination must be accompanied by protection of the future earnings of current workers. While NCSC remains fundamentally opposed in principle to asset reversion, we agree that if withdrawal of surplus assets is allowed, the price should not be plan termination. But we believe that any corporate recapture of assets, whether through withdrawal or termination, must be accompanied by a cost-of-living provision for retired pension beneficiaries. This adjustment should be in proportion to the amount of the asset reversion.

It is only fair for well-funded plans to help retirees maintain a decent standard of living during their retirement. Without adjustments, the value of a pension is eroded over time, especially now that more persons are living well into their eighties.

Retirees fall far behind inflation, finding themselves with less income just when their medical costs are increasing. Finally, there must be strong safeguards on the size of the cushion remaining in the plan.

On the issue of underfunded plans, it is crucial that the PBGC remain economically viable. The recent rash of bankruptcies has placed an unsupportable burden on the PBGC. NCSC would support an across-the-board premium increase, but we oppose the administration's proposal for a risk-related premium which would adversely impact struggling companies and could even force pension terminations or benefit reductions.

We emphatically believe that employers must make adequate provisions to ensure the economic stability of their pension plans. Because Congress has recognized the social value of pensions, employers who provide them receive tax advantages. In return, we feel employers must be willing to live up to their obligations to their workers, retirees and the Federal Government. Nowhere has corporate irresponsibility been more blatant than recent actions which have violated commitments made to retirees.

The most visible case which affects my area very strongly has been that of the LTV Corporation. But they are not the only offender. Many of our members and other retirees have had their lives thrown into turmoil as a result of these broken promises. Thousands of older workers have been asked to take early retirement to make room for younger workers and for the good of the company for which, in many cases, they had worked 30 or 40 years.

In return these older workers were promised pension supplements to tide them over until age 62, when they can receive Social Security and health and life insurance benefits as well. These older workers had no way of knowing that their employer would then declare bankruptcy, leaving them unprotected.

NCSC has received piles of letters from these retirees who are being forced into poverty and feel betrayed by the employer and the country they once believed in. Many have tried unsuccessfully to find work, and others are now working at minimum wage jobs, some in our area at McDonald's and other fastfood chains. They are desperate. They tell us they have little left for groceries after paying their utilities and nothing left to pay their property taxes. They do not understand how a company can be allowed to hide in bankruptcy and shirk its responsibilities.

As the wife of a steelworker wrote, "If it were not for the retirees, the company would not have enjoyed many years of prosperity." As the widow of a steelworker, I agree.

NCSC believes the Federal Government must play a role to prevent flagrant violations of the public trust. Corporations must not be allowed to renege on commitments made to retirees. Promised pension supplements must be protected.

Appropriate legislation is a vital first step in protecting the health benefits of retirees. Back in Ohio and around the country, many retirees are terrified at what will happen if a bankruptcy judge does not restore their lost benefits.

As a result, NCSC believes additional legislation is needed which would allow retirees who lose health benefits to participate in Medicaid until they reach the age of Medicare eligibility.

I have just returned from an 8-day stay in a hospital myself, and I feel for these people. Mine was covered by Medicare and a health plan that I have through the steelworkers. My bill will be close to $10,000 for those 8 days. And I do not know where these people would get that kind of money. If I did not have the protection I have, my home would be on the sales block right now.

I would like to thank Senator Metzenbaum and the rest of the panel for addressing these issues. We feel immediate action is needed to alleviate the anxieties of the present retirees.

[The prepared statement of Ms. Ryan follows:]

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Overfunded and Underfunded Pensions

Testimony Presented Before
the
Senate Committee on Labor and Human Resources
Subcommittee on Labor

and

House Committee on Education and Labor
Subcommittee on Labor-Management Relations

by

Dorothy Ryan, President
Ohio State Council of Senior Citizens

for the

National Council of Senior Citizens

March 24, 1987
Washington, D.C.

Vice President, Dr. Mary C. Mulvey, Providence, Rhode Island **Second Vice President**, George J. Kourpias, Washington, DC
Third Vice President, Dorothy Walker, Detroit, Michigan **Fourth Vice President**, Everett W. Lehmann, Washington, DC
Secretary-Treasurer, Jack Turner, Detroit, Michigan **General Counsel**, Robert J. Mozer, New York

My name is Dorothy Ryan. I am President of the Ohio State Council of Senior Citizens, which is an affiliate of the National Council of Senior Citizens (NCSC). I would like to thank Chairmen Metzenbaum and Clay for holding today's hearing on overfunded and underfunded pension plans. Both these issues have reached crisis proportions and now threaten the economic security of hundreds of thousands of retirees. I will address each of these issues separately.

Overfunded Pensions

NCSC strongly believes that pension plan assets represent the deferred wages of employees. As such, we fundamentally oppose efforts to make it easier for companies to recover so-called "excess" assets from pension plans.

The current situation, in which many defined benefit pension plans are overfunded, is primarily due to recent years of thriving stock market returns and high interest rates. As a result, since 1980, over 1,000 pension plans, representing nearly 1.5 million participants, have been terminated, yielding profits to companies of nearly $12 billion.

When defined benefit plans are terminated, there are often adverse economic consequences for workers and retirees covered by those plans. The result is often smaller pensions, replacement with less adequate defined contribution plans and failure to provide any cost-of-living adjustments for retirees. Furthermore, these trimmed down pension plans may suffer with today's lower interest rates and slower stock market growth. In fact, some may become underfunded, and ultimately add further burden to the Pension Benefit Guarantee Corporation (PBGC).

NCSC agrees with the Administration that pension plan terminations should be avoided, but we do not believe their proposal would be effective in deterring terminations.

NCSC believes the ten percent excise tax on asset reversion terminations should be doubled to 20 percent, and think it would be reasonable to earmark half of such funds to support the PBGC.

In addition, any termination must be accompanied by protection of the future earnings of current workers. While NCSC remains fundamentally opposed in principle to asset reversions, we agree that, if withdrawal of surplus assets is allowed, the price should not be termination of a defined benefit plan which only increases the hardships for present and future retirees. But we believe that any corporate recapture of assets, whether through withdrawal or termination, must be accompanied by a cost-of-living provision for retired pension beneficiaries. This adjustment should be in proportion to the amount of the asset reversion.

It is only fair for well-funded plans to help retirees maintain a decent standard of living during their retirement. Without adjustments, the value of a pension is eroded over time, especially now that more persons are living well into their 80s. Retirees fall far behind inflation, finding themselves with less income just when their medical costs are increasing.

Finally, we cannot overemphasize that any withdrawal of pension funds must not be allowed to jeopardize the security of the plan itself. There must be strong safeguards on the size of the cushion remaining in the plan. It would be an unmitigated disaster to turn overfunded plans into underfunded plans while allowing the companies to profit enormously.

Underfunded Plans

It is crucial that the PBGC remain economically viable and able to safeguard promised retirement income. The recent rash of bankruptcies has placed an unsupportable burden on the PBGC. Last year's premium increase to $8.50 per employee has proved to be an inadequate solution to the present crisis.

NCSC would support an across-the-board premium increase to safeguard the viability of this institution which is vital to the economic security of retirees. We oppose the Administration's proposal for a risk-related premium, which would adversely impact struggling companies and could even force pension terminations or benefit reductions.

We emphatically believe that employers must make adequate provisions to ensure the economic stability of their pension plans. Because Congress has recognized the social value of pensions, employers who provide them receive tax advantages. In return, we feel employers must be willing to live up to their obligations to their workers, retirees, and the Federal government.

Nowhere has corporate irresponsibility been more blatant than in recent actions which have violated commitments made to retirees. The most visible case has been that of the LTV corporation, but they are not the only offender.

NCSC must speak out on behalf of our members and other similarly-situated retirees whose lives have been thrown into turmoil as a result of these broken promises.

Thousands of older workers have been asked to take early retirement to make room for younger workers and "for the good of the company" for which, in many cases, they had worked 30 or 40 years. In return, these older workers were promised pension supplements to tide them over until age 62 when they can receive Social Security. They were promised, in many cases, health and life insurance benefits as well.

These older workers had no way of knowing that their employer would then turn around and declare bankruptcy, leaving them unprotected. NCSC has received piles of letters from these retirees, and again and again they have asked, "When will action be taken on legislation protecting retirees' benefits?" They are asking for help. They are afraid of losing their homes. They do not want welfare, they just want the benefits they were promised. But, they are being forced into poverty and feel betrayed by the employer and the country they once believed in.

Many have tried unsuccessfully to find work and say with discouragement, "Who wants to hire someone 58, 60 years old?" Others are working at minimum wage jobs after devoting more than 30 years to one employer.

They are desperate. They tell us they have little left for groceries after paying their utilities and nothing left to pay their property taxes. They do not understand how a company can be allowed to "hide" in bankruptcy and shirk its responsibilities. As the wife of a steelworker wrote, "If it weren't for the retirees, the company would not have enjoyed many years of prosperity."

NCSC believes there must be better safeguards to protect the promises made to retirees. The Federal government must play a role to prevent flagrant violations of the public trust. Corporations must not be allowed to renege on commitments made to retirees. Promised pension supplements must be protected.

We commend Senator Metzenbaum, Congressman Stokes and their co-sponsors for introducing S. 548 and H.R. 1186, the Retiree Benefits Security Act of 1987. This legislation is a vital first step in protecting the health benefits of retirees and we urge Congress to enact this measure without delay.

I must convey to you, that back in Ohio and around the country, many retirees are terrified about what will happen to them if a bankruptcy judge does not restore their lost benefits. As a result, NCSC believes additional legislation is needed which would allow retirees who lose health benefits to participate in Medicaid until they reach the age of Medicare eligibility. This could be accomplished through a Medicaid buy-in or establishment of state risk pools to insure uncovered individuals.

We would like to thank you again for addressing the crises of overfunded and underfunded pension plans which threaten the economic security of our nation's retirees. Immediate action is needed to alleviate the anxieties of present and future retirees.

Senator **Metzenbaum**. Thank you very much, Ms. Ryan and also you, Mr. Rother.

I have checked with my colleagues, and in the interest of time we are going to waive questions. But we do not want in any way to suggest that we are not impressed with your testimony. I am very appreciative of your testimony and expect to work with both of you and the organizations you represent in the coming weeks in order to try and fashion a bill that will meet the objectives that all of us have.

Thank you very much.

Mr. **Rother**. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Our next panel consists of Lawrence Smedley, Assistant Director, Department of Occupational Safety, Health and Social Security, AFL-CIO, Washington, DC; Dr. William Hoffman, Director of Social Security Department, the United Auto Workers, Detroit, MI; and Jack Sheehan, Assistant to President Lynn Williams, United Steelworkers of America, Washington, DC.

We are happy to have all of you with us here, and I think you know our rules. All of you are familiar with the Washington committee procedures, and I am sure will limit your remarks—you might even cut it down to less than 4 minutes if we pay special heed to what you are saying.

Mr. Smedley, we will hear from you first.

STATEMENTS OF LAWRENCE SMEDLEY, ASSISTANT DIRECTOR, DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY, AFL-CIO, WASHINGTON, DC; DR. WILLIAM HOFFMAN, DIRECTOR OF SOCIAL SECURITY DEPARTMENT, UNITED AUTO WORKERS, DETROIT, MI; AND JACK SHEEHAN, ASSISTANT TO PRESIDENT LYNN WILLIAMS, UNITED STEELWORKERS OF AMERICA, WASHINGTON, DC, ACCOMPANIED BY KAREN FELDMAN, LEGAL DEPARTMENT, PITTSBURGH, PA

Mr. **Smedley**. Thank you, Mr. Chairman.

We appreciate the opportunity to present our views on the administration's proposals for the funding and termination of defined benefit pension plans.

Let me quickly summarize some of the AFL-CIO's major objections with the administration proposals.

First, on asset withdrawals. This proposal would encourage employers to choose terminations rather than using the withdrawal option. Since an employer could take back all the excess assets, but in a withdrawal would have to keep an asset cushion in the plan.

Though terminating employers could not establish another defined benefit plan for five years, employers would not be deterred, and would at best replace defined benefit plans with defined contribution plans which provide inferior retirement protections.

Clearly, employer contributions paid into a pension fund have been earned by workers and represent current wages withheld to pay a benefit on retirement.

Now, Congressman Roybal's proposal, as he mentioned in his statement today, would fully recognize that principle.

Mr. Kass mentioned the Advisory Council report, which recommended a sharing of these assets. I was a member of that Council, and I do not recollect seeing it as he described it. I just happen to have in my briefcase the report of the Advisory Council and would rather let them speak for themselves. I will read you their recommendations.

> We fully understand that the arguments which no doubt would be made by the Department of Treasury and others are that some portion of the surcharge should be in the form of an excise tax. However, we believe the equities require that a share of the reverted excess assets should be to enhance worker and retiree benefits, and we so recommend.

Senator METZENBAUM. Whose recommendation was that?

Mr. SMEDLEY. That is the Advisory Council, the Secretary of Labor's and the Department of Labor's own Advisory Council. I must say, Mr. Chairman, it is unfortunate the Secretary failed to support his own Advisory Council's recommendation in his proposals.

Now, on the minimum funding standards, clearly, of all the administration proposals, the minimum funding standards would have the greatest immediate impact and would hit hardest on troubled industries. Such standards must strike a balance between the need to soundly finance pension plans and avoidance of the kind of impact that could lead to cessation of business operations and termination of a plan.

The minimum funding standards must be greatly modified to reduce their cost impact.

Now, on the termination of underfunded plans, of great concern is the requirement that if a plan's termination liability exceeds its assets, the assets of the group's other plans will have to be transferred to the terminating plan to cover its liability. This results in transfer of assets among plans with different participants. We are opposed to any proposal which would allow an employer to grab the assets of a collectively-bargained pension plan and use those assets to benefit a non-union pension fund.

Similarly, if an employer is entitled to a withdrawal of surplus assets from a pension plan, such assets could be transferred to funds covering health benefits of current retirees. As in the case of transfer of pension funds, we strongly object to this when it transfers assets among plans with different participants.

May I say, Mr. Chairman, in conclusion I have of necessity confined my remarks to those aspects of the administration proposals that are most unsatisfactory. A number of them are quite worthwhile and deserve support.

For this reason, the AFL-CIO is willing to work with all interested parties to design acceptable legislation and is prepared to fully cooperate in efforts to advance that objective.

Thank you.

Senator METZENBAUM. Thank you very much, Mr. Smedley.

I might say that the entire statements of each of you will be included in the record.

[The prepared statement of Mr. Smedley follows:]

87-15

STATEMENT BY LAWRENCE T. SMEDLEY, ASSOCIATE DIRECTOR AFL-CIO DEPARTMENT OF OCCUPATIONAL SAFETY, HEALTH AND SOCIAL SECURITY AT THE JOINT HEARINGS OF THE SENATE SUBCOMMITTEE ON LABOR AND THE HOUSE SUBCOMMITTEE ON LABOR MANAGEMENT RELATIONS ON ADMINISTRATION PROPOSALS FOR THE FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

March 24, 1987

The AFL-CIO appreciates the opportunity to present our views on the Administration's proposals for the funding and termination of single-employer defined benefit pension plans. We commend Chairmen Metzenbaum and Clay for holding these hearings and for the leadership they have shown on these issues.

The AFL-CIO supported enactment of the Employees Retirement Income Security Act because it would be beneficial to workers and their families. Like most laws, it is not perfect. Though we are dissatisfied with a number of its provisions and with some aspects of its administration, we still feel the law is beneficial and support its basic provisions.

No section of the law had greater support from organized labor than Title IV which created the Pension Benefit Guaranty Corporation (PBGC) to protect beneficiaries against loss of pensions on plan termination where assets are inadequate.

Since its enactment, there have been two severe recessions and thousands of plant closings and pension plan terminations. The PBGC has provided vital help to workers in these situations by guaranteeing them at least some pension benefits.

Organized labor has taken the position that any legislation must maintain and enhance existing benefit guarantees. We will oppose any proposals to circumscribe the circumstances under which pensions are protected.

Asset Withdrawals

When a pension plan is included in a collective bargaining agreement, both parties explicity or implicitly acknowledge that it is, in fact, a part of the wages and conditions of employment which workers are to receive in exchange for their labor. In short, a collectively bargained pension represents current wages withheld to pay a benefit on retirement.

To many, the fact that a collectively bargained retirement plan is a form of compensation may seem too obvious to require further argument. Nevertheless, it is a point worth remembering and emphasizing. It has a very important bearing upon many questions which are bound to arise with regard to the rights of workers under a pension plan.

The Administration's proposal generally permits employers to recover so-called "excess assets" from ongoing defined benefit plans provided that certain conditions are met. The objective is to provide employers with an alternative to termination by allowing them to tap excess assets without terminating the plan.

An employer would be permitted to withdraw assets from an ongoing defined benefit plan to the extent that, after the withdrawal, the value of the assets and of the assets in the other plans of the employer and of the control group of which the employer may be a part exceeds a "minimum benefit security level." Only amounts in excess of 125 percent of plan liabilities measured on a termination basis, or the amount determined by a formula based on a projected unit credit method, would be available for withdrawal. For annuitized benefits, the amount of the cushion would be reduced. A ten percent excise tax and the appropriate income tax would be applied to all withdrawals as well as termination reversions.

In our opinion, the proposal would encourage employers to choose termination rather than using the withdrawal option since, in a termination, an employer could take back all the excess assets (subject to taxes), but in a withdrawal would have to keep an asset cushion in the plan. The objective should be to discourage not encourage terminations.

Though the terminating employer could not establish another defined benefit plan for five years, this so-called "five year curse" would do little to deter terminations. The employers would, at best, replace the defined benefit plans with defined contribution plans. The result would be to undermine defined benefit plans which provide workers with better retirement protection.

The proposal would also encourage employers to annuitize the liability of retirees by permitting a lower cushion when this is done. Plans often grant ad hoc cost of living increases to retirees when they experience investment gains and/or have excess assets. Unfortunately, the taking of plan assets by employers would greatly reduce that possibility and transferring the plan's retirees to an insurance company through the purchase of annuities would virtually eliminate any possibility for such increases.

As pointed out earlier, employer contributions paid into a pension fund have been earned by workers. The amounts contributed by the employer to finance the pension credits accumulated by each worker should, therefore, be an irrevocable payment which the employer cannot withhold or recapture just as an employer cannot withhold or recapture cash wage payments.

The Department of Labor's own Task Force on Asset Reversions and its Advisory Council on Health, Welfare and Benefit Plans have recognized this principle by suggesting that workers and retirees share in surplus assets when a termination takes place. In addition, both groups felt it imperative to insure there is no incentive to terminate because the employer could do better by terminating than using the withdrawal option. They dealt with both problems by recommending, that on termination, workers and retirees share an amount equal to the cushion required on a withdrawal.

Both the Task Force and the Advisory Council also recommended that a withdrawal of assets be considered an experience loss and amortized over 10 years. Congress should include such a provision in any legislation on termination reversions that includes a withdrawal mechanism.

Minimum Funding Standards

Of all the Administration's proposals, the minimum funding standards would have the greatest immediate impact. Plans would be required to fund unfunded liabilities within a minimum range of three to five years to a maximum of the number of years remaining under the plan's existing amortization base.

Underfunded plans are defined as those which have assets less than 110 percent of termination liabilities. Special minimum funding rules would apply to these plans based on a Funded Ratio. This ratio would be the actuarial value of plan assets divided by 110 percent of the plan's termination liability to participants. The lower the plan's Funded Ratio, the shorter the amortization period.

In the event of a funding decline, a minimum amortization base would be created by multiplying the plan's termination liability after the decline by the amount of the decline in the ratio. This amount would have to be amortized over three years.

Waivers from minimum funding requirements would be greatly restricted. The proposal requires that waived contributions be amortized within a period of years determined by multiplying 15 years by the plan's funded ratio and, in no case, could the result exceed 15 years. The general tightening of the waiver standards would appear to virtually disqualify plan sponsors from funding waivers except in cases of hardship resulting from temporary cash flow problems. Plan sponsors, who are severely impacted by the minimum funding standards, would either not qualify for a waiver or it would be of very limited value in helping them deal with their financial difficulties.

Unfortunately, the Administration proposals do not provide a schedule detailing the relationship between Funded Ratios and amortization periods. However, it is clear that the amortization period for the liabilities of some plans could be as short as three to five years as compared with the current 30 years.

It is obvious that these funding proposals would have a major cost impact on some employers. These employers, for the most part, are more numerous in troubled industries. Layoffs, early retirements and deferred funding in order to deal with pressing financial problems have prevented them from achieving actuarial funding assumptions for their pension plans. Employers that could otherwise survive might be pushed over the edge by the these funding standards.

Funding standards must strike a balance between the need to soundly finance pension plans and avoidance of the kind of impact that could lead to cessation of business operations and termination of the plan. In short, requiring excessively rapid funding at the time a company is experiencing economic difficulties would, at the very least, make its survival more difficult and could cause its demise. The end result could place a greater burden on the PBGC, not less.

We are aware that to require employers to improve the funding of their pension plans will in the long run strengthen retirement security for workers. But the proposed standards do not differentiate between the prosperous and hardship cases and would disproportionately impact on the latter. Any changes in minimum funding standards must be realistic as to their cost burden and economic impact on pension plan sponsors.

The Administration proposals deal with PBGC's long run problems. The resolution of its short run problems will require additional and separate legislation. Thus, any realistic changes, though taking longer to increase funding levels, will avoid serious adverse impact on financially troubled employers.

However, in the last analysis, strengthening of the economy is the most effective means of protecting the PBGC. This will require trade and economic policies that will enable plan sponsors to achieve profitability and to stay in business so that they can continue their plans and maintain their funding obligations.

Let me now turn to some positive features of the proposed minimum funding standards.

Liability for the funding requirements would be on a control group basis. This would force employers to be responsible for, and to plan pension financing, on a comprehensive basis covering all their plans.

If a plan's Funded Ratio is less than 100 percent, the plan would have to make annual contributions at least equal to the annual benefit payout plus administrative expenses. Under present law, a pension plan can, in some situations, meet minimum funding standards and still continue to have its unfunded liability increase. It is important to plug this loophole.

The deadline for minimum required contributions would be accelerated to 2½ months after the close of the plan year, from 8½ months now. This would strengthen plan funding.

Termination of Underfunded Plans

The Administration proposals make a number of major revisions in the provisions of current law pertaining to pension plan liability when an underfunded plan is terminated. Some of these proposed changes are to the benefit of participants. For example, in a distress situation, the employer's liability for unfunded benefits would be increased to the plan's termination liability.

Similarly, the required plan asset level for a standard termination would be raised from the benefit commitments standard of present law to the full level of the plan's termination liability to participants. In spite of the improvements enacted in the single-employer termination insurance program last year, profitable employers can still evade responsibility for certain non-guaranteed benefits. This provision would help with these kinds of problems.

Of great concern, is the requirement that, if a plan's termination liability exceeds its assets, the assets of the control group's other plans would have to be transferred to the terminating plan to cover its liability, provided the transfer does not reduce the assets in the ongoing plan to less than the plan's termination liability. This would result in transfer of assets among plans with different participants.

As we have emphasized, a pension plan is not a conditional or discretionary gift by the employer. Rather it represents current wages withheld to pay a benefit on retirement. This proposal could result in employers taking the deferred wages which workers have won through collective bargaining and transferring them to non-union pension funds.

When investment earnings are high and a pension plan well funded, a union can negotiate benefit improvements or larger wage increases or a combination of both. Also ad hoc cost of living adjustments for retirees can take place. We are opposed to any proposal which would allow an employer to grab the assets of a collectively bargained pension plan and use these assets to benefit a non-union pension fund.

These provisions would also prohibit an employer from establishing plans that provide substantially similar benefits within five years after termination of a plan that did not have adequate assets to provide PBGC guaranteed benefits. Since no legislative language yet exists for the Administration's proposals, we cannot be sure of the exact meaning of this provision. However, it appears to prohibit the negotiation of substantially similar benefits even when no new PBGC liability is created. This would be an unwarranted and unnecessary intrusion into the collective bargaining process.

Retiree Health Benefits

If an employer is entitled to a withdrawal of surplus assets from a pension plan, such assets could be transferred to accounts covering health benefits of current retirees. Assets transferred in this manner would be exempt from the taxes that would be applicable in the cases of withdrawals or reversions.

We have no objection to this procedure in those cases where the transfer of assets involves the same group of employees covered by the collective bargaining agreement. As in the case of transfers to pension funds, we strongly object to this when the transfer of assets is among plans with different participants since the result could be the transfer of collectively bargained deferred wages of union workers to non-union health plans. We assume, of course, there is no intention to interfere with the right to make such transfers the subject of collective bargaining.

Conclusion

At long last, it has become clear to the Administration what has long been obvious to all responsible persons with a stake in the private pension system-something must be done to deal with the abuses that are occurring with pension plan terminations. Though all of us may agree that something needs to be done, major disagreements exist concerning what specific actions should be taken. Though we find some of the Administration's proposals unacceptable; others deserve support. For this reason, the AFL-CIO is willing to work with all interested parties to design acceptable legislation and is prepared to fully cooperate in efforts to advance that objective. We commend the Subcommittees for holding these hearings and will be happy to work with you on these important issues.

Senator METZENBAUM. Dr. Hoffman, we are happy to have you with us this morning.

Dr. HOFFMAN. Thank you, Senator.

My name is William Hoffman. I am Director of the UAW Social Security Department. I appear today on behalf of 1.5 million active and retired UAW members and their spouses, most of whom are participants in defined benefit pension plans. The UAW commends you for holding hearings on these critical issues associated with funding and termination of defined benefit plans as well as your past efforts in support of the private pension system.

We are very proud of the role the UAW has played over the long haul in the struggle to achieve adequate and secure retirement income for workers and their families.

We need action today to address the PBGC's financing problems. Some action is also needed to assure that the funding status of existing pension plans does not deteriorate in the future, thereby exposing participants as well as, but to a lesser extent of our concern, PBGC, to further losses.

We must approach solutions to these problems with precision and great care. A so-called solution which undermines the defined benefit pension systems' ability to provide adequate retirement income through overly conservative, stringent requirement is, I submit, no solution at all.

We need a balanced approach between retirement income needs and an ongoing pension plan on the one hand, and funding and other provisions in anticipation of termination, on the other.

The UAW believes that the most urgent need is to provide additional financing for the PBGC. The $8.50 premium is insufficient to cover PBGC's anticipated claims as well as current deficit.

We would support an immediate increase in the PBGC premium. We would also support additional annual premium increases in the future or a permanent indexing of the premium. We also believe that other revenue sources such as earmarking the excise tax on reversions for the PBGC should be considered.

A cash flow test should be established which would require that contributions to a plan exceed benefit payments and expenses for each year. This would assure that the funding status of pension plans would not deteriorate.

We believe it is also appropriate for the Government to consider requiring faster funding for newly-created pension liabilities. If such funding requirements are limited to new liabilities, and these requirements are gradually phased in over a period of years, we believe that faster funding can be implemented without disrupting the defined pension benefit system and without creating undue economic hardship on employers who may already be experiencing serious financial difficulties.

The administration's proposal for faster funding for existing pension liabilities causes us great concern. It is apparent that the administration is proposing that plans, which are less than fully funded for all accrued benefits, could be subjected to faster funding for all existing liabilities. This amounts to changing the rules in the middle of the game and is unfair.

The administration would shorten the amortization period for existing liabilities for some plans to as little as 3 to 5 years. Such a change could double or triple existing pension costs for existing benefits.

Even a 15-year amortization period would increase pension costs by about 30 percent. Importantly, we should keep in mind as we look for a solution that had such a proposal been enacted when Chrysler was in financial difficulty, Chrysler might not have recovered. This would have been counterproductive and harmful to the participants, the Corporation and PBGC.

As a matter of principle, the UAW submits that any excess assets should belong entirely to plan participants because the pension contributions represent deferred wages. However, we recognize that there are contrary views to this subject, and in the interest of furthering the legislative solution, the UAW is willing to support legislation that would call for equitable sharing of the so-called excess assets between participants and employers. I must stress, however, that the legislation in this area, at a minimum, would require that benefit expectations be fully recognized in terms of the participants' right to future benefits.

Thank you. I know that the record will have the full submission.

Senator METZENBAUM. Thank you very much, Dr. Hoffman.

[The prepared statement of Dr. Hoffman follows:]

March 24, 1987

Statement

of

William S. Hoffman, Ph.D.
Director, Social Security Department
International Union, UAW

on the subject of

THE FUNDING AND TERMINATION OF PENSION PLANS

before the

Subcommittee on Labor-Management Relations
Committee on Education & Labor
U. S. House of Representatives

and

Subcommittee on Labor
Committee on Labor & Human Resources
U. S. Senate

On behalf of:
International Union, United Automobile,
Aerospace & Agricultural Implement
Workers of America, UAW

Messrs. Chairmen, my name is William Hoffman. I am Director of the UAW's Social Security Department. I am appearing today on behalf of 1.5 million active and retired UAW members and their spouses, most of whom are participants in defined benefit pension plans. As such, we represent about 5% of the participants in our nation's defined benefit pension plans. The UAW commends you for holding hearings on the critical issues associated with the funding and termination of defined benefit plans, and for your past efforts in support of the private pension system.

We are proud of the role the UAW has played in the struggle to achieve adequate and secure retirement income for workers and their families. We have been active in this pursuit for nearly forty years at the collective bargaining table, as well as in the legislative arena.

In 1950, UAW members struck the Chrysler Corporation to establish the principle that pension plans should be adequately funded. Chrysler's approach was to pay pension benefits out of its general treasury, instead of funding them through a trust fund. The UAW insisted that the pension benefits be funded in order for the pension promises to be secure. After striking for 104 days, the UAW finally prevailed. The principle that pension benefits should be funded became the standard pattern for UAW negotiated contracts.

The UAW was also one of the first organizations to call for the enactment of federal legislation establishing minimum funding standards for all pension plans. We wholeheartedly supported the funding standards that were ultimately included in Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Most UAW collective bargaining agreements already required 30 year funding of past service liabilities.

Nevertheless, we recognized that the enactment of statutory minimum funding standards was necessary for pension plans.

In our judgment, the minimum funding standards mandated by ERISA have been a success. They have played an important role in assuring that most pension plans are adequately funded.

However, when Congress enacted ERISA, it recognized that the establishment of minimum funding standards would not be enough to solve the "Studebaker" type of problem which had so shocked the conscience of the nation - that is, situations in which workers and retirees lost a substantial portion of their vested pension benefits because a company experiencing severe economic difficulty terminated its pension plan and the plan had insufficient assets to pay all vested benefits. To address the "Studebaker" problem, Congress also provided for the establishment of the pension plan termination insurance program in Title IV of ERISA.

The UAW believes that the termination insurance program has been largely successful in achieving its intended objectives. The Pension Benefit Guaranty Corporation (PBGC) has been instrumental in guaranteeing that thousands of participants and beneficiaries received at least a portion of their anticipated benefits when economically-troubled companies terminated their pension plans and there were insufficient assets to pay all vested benefits.

In 1986, after years of debate, Congress finally enacted the Single Employer Pension Plan Amendments Act (SEPPAA). This legislation greatly strengthened the termination insurance program by providing the PBGC with a long overdue premium increase, and by closing loopholes in ERISA which had enabled some profitable employers to dump unfunded pension liabilities onto the PBGC and to evade responsibility for certain vested non-guaranteed benefits which had been earned by participants. However, developments since the enactment of SEPPAA demonstrate that additional legislation is required to address a number of problems facing the defined benefit pension system.

Several pension plans with large unfunded liabilities have recently terminated. In particular, the termination of the LTV Steel pension plans has nearly doubled the PBGC's liabilities. These terminations and the resulting increases in PBGC's liabilities make it clear that some action is needed to address the PBGC's financing problems. Some action is also needed to assure that the funding status of existing pension plans does not deteriorate in the future, thereby exposing the participants and the PBGC to further losses.

We must approach solutions to these problems with precision and great care. A so-called "solution" which undermines the defined benefit pension systems' ability to provide adequate retirement income through overly conservative, stringent requirements is, I submit, no solution at all. We need a balanced approach between retirement income needs in an ongoing plan on the one hand and funding and other provisions in anticipation of termination on the other.

In addition, there is a need for action to resolve the various abuses which have occurred in recent years in connection with the termination of so-called "over funded" plans and the reversion of excess assets to employers. Let me address each of these issues in turn.

Financing of the Pension Benefit Guaranty Corporation (PBGC)

The UAW believes that the most urgent need is to provide additional financing for the PBGC. The $8.50 premium is insufficient to cover PBGC's anticipated claims and current deficit. The recent LTV pension plan terminations added in excess of $2 billion of unfunded liabilities to the PBGC's $2.3 billion shortfall. Increased financing is needed to eliminate this deficit as well as to cover anticipated claims.

The Administration's pension proposals do not address this issue. This, I believe, is a serious deficiency. In our judgment, any pension legislation must deal with the PBGC's financing problems.

The UAW supports an immediate increase in the PBGC premium. We support provisions for additional, annual premium increases in the future or a permanent indexing of the premium. We also believe that other revenue sources, such as earmarking the excise tax on reversions for the PBGC, should be considered by Congress.

For several months, officials of the PBGC have been talking about modifying the existing premium structure so that it would be based upon the unfunded liabilities of a pension plan per participant. The UAW strongly opposes any variable rate premium proposal. Such a proposal would result in a very limited increase in premiums for some employers but would drastically increase the premiums of other employers.

Unfunded liabilities in pension funds primarily result when credit for past service is recognized at the time benefit increases are provided or when a plan is established. This is a very desirable practice which permits pensions to more adequately meet current retirement income needs. Such increases in liability are amortized over a period of years much like a home mortgage. For almost all UAW employers, these unfunded liabilities do not present any risk to the PBGC. The companies are financially healthy and can manage the increased costs. It is wrong to require these employers through a variable rate premium to take on a disproportionate share of the burden created by a few employers who terminate their plans in a "distress situation". This will simply discourage economically healthy employers from granting credit for past service, and thus will undermine the retirement income needs of participants.

The UAW supports making employers fully liable for all promised pension benefits, both under a "standard" and a "distress" termination. In our judgment, this will help to provide increased protection for participants, and also will have a positive impact on the financial condition of the PBGC.

Minimum Funding Standards

Pension plans are generally better funded today than in 1976 when ERISA's minimum funding standards became effective. The recent termination of several pension plans with large unfunded liabilities should not be viewed as evidence that ERISA's minimum funding standards have failed.

Nevertheless, the UAW recognizes that some changes in the minimum funding standards are appropriate to assure that the funding status of existing plans does not deteriorate in the future. In making such changes, we would stress that a balance must be struck between retirement income needs and funding security.

The UAW supports the principle that a cash flow test should be established which would require that contributions to a plan exceed benefit payments and expenses for each year. A cash flow test would assure that the funding status of a plan does not deteriorate. Had such a provision been in effect, it would have prevented the assets of the Allis Chalmers and the LTV Steel salaried plans from deteriorating.

The UAW also strongly supports making the entire controlled group of a plan sponsor liable for funding the plan. This will help assure that funding continues in situations where the controlled group is solvent, notwithstanding the demise of the plan sponsor itself.

The UAW also supports the principle of accelerating the due date for pension contributions.

The UAW supports a requirement that the IRS evaluate the entire controlled group of a plan sponsor in deciding whether a waiver is appropriate. However, we are opposed to proposals to tighten the standards for granting a waiver and the amortization periods for repaying waived contributions. The IRS already has wide discretion over whether and under what terms a waiver should be granted. We do not believe it would be useful to put the IRS in a straightjacket, especially since these determinations must necessarily depend on the facts of each particular case.

It is also important to recognize that actuarial assumptions have a large impact on employer contributions to a pension plan. These assumptions vary tremendously from plan to plan and employer to employer. The UAW believes these assumptions should be more carefully scrutinized by the IRS and, where appropriate, challenged.

In addition to the various changes discussed above, the UAW believes it would be appropriate for the government to consider requiring faster funding for newly created pension liabilities. Faster funding of newly created liabilities, such as future benefit improvements, would assure that these liabilities are funded on a more conservative basis and would also result in better funding for all plans. If such funding requirements are limited to new liabilities, and these requirements are gradually phased in over a period of years, we believe that faster funding can be implemented without disrupting the defined benefit pension system and without creating undue economic hardships for those employers who are already experiencing serious financial difficulties. We would note, however, that any proposals for faster funding must be coupled with reforms (discussed below) relating to the reversion of "excess" assets upon the termination of a plan since faster funding would otherwise aggravate the already serious problems which have arisen in this area.

The Administration's proposals to require faster funding for existing pension liabilities cause us great concern. Despite repeated requests, the Administration has not released details on the new amortization schedules which would be required under their proposals. Thus, it is impossible to determine what the precise impact would be on any particular plan or employer.

Notwithstanding the lack of specificity, it is apparent that the Administration is proposing that plans which are less than fully funded for all accrued benefits could be subjected to faster funding for all unfunded liabilities. I would like to emphasize that this accelerated funding proposal would apply to existing liabilities. This amounts to changing the rules in the middle of a game and is unfair. Moreover, it would impose serious financial hardship on some employers, and could also endanger the adequacy of retirement monies provided by the defined benefit pension system.

Under current law unfunded liabilities are amortized over thirty years. Liabilities which were in existence prior to 1976 were allowed to be reamortized over forty years.

The Administration would shorten the amortization period for existing unfunded liabilities for some plans to as little as three to five years. Moving from current law to such a short period could double or even triple pension costs for existing benefits. Even fifteen year amortization of existing liabilities could increase such past service costs by 30%. Had such a proposal been enacted when Chrysler was in financial trouble, Chrysler might not have recovered. This would have been counterproductive and harmful to the PBGC, as well as the workers and retirees of Chrysler.

The issue which must be addressed here is one of balance. It is important to properly fund a pension plan. It is also important to maintain a pension system that meets current retirement income needs. To reduce the amortization period of existing liabilities, as the Administration proposes, would dramatically and unnecessarily increase costs and, I believe, significantly undermine the retirement income available to workers and retirees.

Reversion of Excess Assets to an Employer

In recent years there has been a growing problem associated with employers terminating pension plans in order to obtain a reversion of so-called "excess" assets — that is, assets in excess of the amount needed to cover all accrued benefits. These termination-reversions have frustrated the legitimate retirement expectations of thousands of workers and retirees. They have allso raised a serious threat to the stability of and confidence in the private pension system.

Unfortunately the Administration has chosen to ignore this problem and the recommendations of the Task Force on Reversions appointed by Secretary Brock and of the ERISA Advisory Council concerning termination-reversions. Instead of building on the groundwork established by the Task Force and Advisory Council, the Administration has developed a new proposal — a proposal which appears to be guided solely by a desire to protect the interests of the PBGC, rather than the interests of plan participants.

As a matter of principle, the UAW submits that any "excess" assets should belong entirely to the plan participants because the pension contributions represented deferred wages. However, we recognize that there are contrary views on this point. In the interests of furthering a legislative compromise which will provide an early solution to the problems posed by termination-reversions, the UAW is willing to support legislation that would provide for some equitable sharing of the "excess" assets between participants and employers. We must stress, however, that the UAW cannot support any legislative proposal in this area unless it provides, at a minimum, that upon the termination of a plan any "excess" assets must first be used to compensate active and retired participants for the legitimate benefit expectations which have been frustrated by the plan termination. Only after such benefit expectations have been satisfied should assets be allowed to revert to the employer.

There are many arguments for allowing active and retired participants to share in a portion of the excess assets. Under the Internal Revenue Code, contributions to a "qualified" pension plan are immediately tax deductible for employers. However, one of the conditions which must be met in order for a pension plan to be "qualified" is that the plan must be intended to be permanent. In many cases, the reason pension plans have assets in excess of their termination liability is precisely because the plans were terminated prematurely. For example, in salary-related plans the excess assets typically represent monies that were contributed for the purpose of funding benefits which would have been paid had the plan continued and salaries increased. Similarly, in flat-benefit plans the excess assets may often result from the fact that many workers are just shy of eligibility for early retirement benefits, such as an unreduced lifetime benefit or supplementary benefits payable until the age at which Social Security benefits commence. In addition, premature termination of a pension plan clearly jeopardizes the future retirement security of participants by effectively foreclosing the possibility of future cost of living and real income increases. For all of these reasons, active and retired participants have a right to share any excess assets which exist when a plan is prematurely terminated.

In our judgment, the Administration's proposal is fatally flawed because it fails to recognize this basic principle. But the Administration's proposal also contains numerous other problems.

Under current law, an employer may receive a reversion of excess assets upon the termination of a plan only if the plan contains express language allowing such a reversion. The Administration's proposal would effectively repeal this rule, and allow employers to obtain reversions regardless of the plan provisions (and indeed, even if the plan expressly prohibited reversions). The UAW believes that this proposed dilution of the protections afforded by existing law is outrageous, and we trust that Congress will not countenance such suggestions.

The Administration has also proposed that employers be permitted to withdraw a portion of the excess assets from an ongoing plan. However, the way the proposal is structured, the amount of assets an employer could obtain upon termination of a plan would often exceed the amount which could be withdrawn from an on-going plan. Thus, the Administration's proposal would not discourage employers from terminating plans, it would simply give employers an additional mechanism for obtaining access to "excess" assets. This simply does not make sense. The UAW submits that any withdrawal mechansim should be considered only if it is coupled with sufficient restrictions on termination-reversions so that employers will be discouraged from terminating their plans. In addition, sufficient assets should always be left in the plan to cover all accrued benefits plus the additional amount which would be paid out to participants if the plan terminates. The withdrawal should be treated as an actuarial loss for funding purposes. In order for a withdrawal to take place, the plan should have language which permits a withdrawal.

The Administration's proposal also would require that the excess assets in a particular pension plan be transferred to other pension plans maintained by the same employer or other member of that employer's controlled group in various situations. This part of the Administration's proposal violates the exclusive benefit rule which lies at the heart of ERISA's fiduciary duty provisions. The UAW submits that it would be fundamentally unfair to require pension funds which have been contributed on behalf of one group of participants (and which represent deferred wages for those participants) to be suddenly transferred to another pension plan for the benefit of an entirely different group of participants. The Administration's rationale for this proposal, presumably, is to provide maximum protection for the PBGC. But this puts the cart before the horse. The basic objective of our pension laws should be to promote the interests of participants, not the interests of a government agency.

The Administration's proposal also contains a number of elements that would tend to undermine the defined benefit pension system. Specifically, the Administration has proposed that employers be allowed to receive a larger reversion if they terminate all of their defined benefit pension plans. The Administration has also proposed that employers be precluded from establishing any new defined benefit pension plans for the same group of participants for a period of five years after the termination of an underfunded or overfunded plan. The UAW submits that these proposals are ill-conceived and counterproductive. Rather than strengthening the defined benefit pension system they would encourage employers to flee the system (thereby further undermining the PBGC).

The Administration has also proposed that employers be granted an additional tax incentive if, upon withdrawing excess assets from an ongoing pension plan, the employer immediately transfers those assets to a fund which would be used to provide health insurance benefits to current retirees. The problems associated with providing adequate and secure health care benefits to retirees are extremely complex and difficult. The proposal advanced by the Administration, however, will not provide any meaningful solution to those problems. Even worse, the Administration's proposal would countenance the transfer of pension assets from one group of participants, such as rank and file workers, to an entirely different group of persons, such as salaried retirees. Again, this violates the exclusive benefit principle and is fundamentally unfair.

The termination of pension plans with a reversion of so-called "excess assets" to employers remains an area of serious concern to the UAW. The UAW is willing to work with the Administration and Congress in fashioning a proposal which will stop the serious abuses in this area and recognize the legitimate benefit expectations of participants.

In closing, I would like to emphasize the importance of pension plans to the retirement income security of UAW members and other working and retired Americans. Defined benefits plans are the best vehicle for providing this security:

1. They allow increases in benefits for past service thus allowing periodic benefit adjustments to meet current income needs.

2. They have the flexibility to provide adequate levels for disability retirement benefits, survivor benefits and early retirement benefits.

3. They do not place investment risk on the plan participant.

4. They allow the plan sponsor reasonable flexibility in funding.

The UAW strongly supports sound pension funding. It is now apparent that some adjustments in the minimum funding requirements of ERISA are needed, as well as additional financing for the PBGC. As these needs are considered, we urge you to balance them with other needs; the needs of participants in defined benefit plans to continue to have these plans provide them with adequate levels of income, as well as to have their benefits securely financed.

The UAW would again like to thank Chairmen Clay and Metzenbaum for holding early hearings on these important issues. On behalf of the UAW, I want to express our wish to work with you in shaping solutions to these problems.

Thank you.

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Senator METZENBAUM. My old friend, Jack Sheehan; happy to welcome you back this morning, Jack.

Mr. SHEEHAN. Thank you, Mr. Chairman. I am accompanied this morning by Karen Feldman, from our Legal Department, Pittsburgh, PA. And I regret we have so little time to say so much, and therefore I will just read from some written notes and probably risk not saying what I would really like to say.

First off, point number one, Mr. Chairman, what you are experiencing is the pension system being stressed to its ultimate in an industry which is undergoing restructuring. We submit in this statement, Mr. Chairman, that currently, the PBGC is ill-equipped, and perhaps our own pension laws are ill-equipped to handle the problems confronting a restructuring industry and the pension commitments to its employees.

In particular our concern is with the manpower reductions in the steel industry, the impact of which is to be ameliorated through early pension retirements. Early retirements are socially the best way to help in the reduction of manpower in the industry. However, it is those early pension retirements benefits, Mr. Chairman, which are not being guaranteed by the PBGC.

You heard one of the victims this morning. I refer in particular to one benefit, namely the $400 supplement. In our testimony, Mr. Chairman, we make reference to a tragic situation where one of our members committed suicide as a result of the withdrawal of the $400. He is a person that has really been affected under two circumstances because of the pension system. He was adversely affected first because many of his pension credits which were accrued prior to 1974 when ERISA was enacted were lost when he moved from one company to another. Secondly, he lost the early retirement benefit supplement—namely, the $400. He has committed suicide, and unfortunately as this tale unfolds, his wife now is receiving $120 a month from a pension that originally was $622.

This brings me to the second point, Mr. Chairman, the unbelievable pressure that we are receiving from the PBGC in the area of negotiating follow-on programs after a pension plan has been terminated. The union is now being barred from taking any collective bargaining action to make whole, if you wish, the gap between the PBGC guarantee and the amount that the pensioner is entitled to as a result of an early plant shutdown. It is benefit formula introduced into the contract as a method of assisting in restructuring of the steel industry.

Now, the third point that I make in these general remarks has to do with the situation that perhaps, at least in steel, if not in other industries in the manufacturing sector, we will have to begin to look at from an industry-specific response. To that extent, we would seek a separate tracking of these particular funding obligations due to the early shutdown benefits.

With regard to the administration proposals, in particular the minimum funding requirements, again, there is an agreement; we do accept the need for a more rapid funding of these obligations. However, like my colleagues, I would hasten to add that we have to put a caveat that the rapid funding ought not push the company over the edge. But nevertheless, we do feel that we ought to speed up the funding requirements.

The waiver situation has gotten out-of-hand. We suggest and do support limitations on the waivers.

Another point I would like to make with regard to the funding of these obligations is that at least one principle ought to be observed. That is known as the "cash flow" test. In other words, these plans ought to be funded at least at the rate at which we are paying benefits out each month.

Another point is that the premium is now $8.50. That is very small, Mr. Chairman, in terms of a whole year's contribution. We do suggest that those premiums could very easily be increased in order to assist the PBGC in its deficit which it has now incurred.

We do, however, oppose variable premium rates. And one final point, and I think it is important because you have been talking about it all day today, is that we oppose accessing the excess funding of these pension plans. Deferred benefits or otherwise, those funds should remain in those plans, and we should have no accessing of those plans.

We make one small exception that, where the health care benefits of employees are not being funded, the accessing for those benefits might be advisable.

Thank you.

[The prepared statement of Mr. Sheehan follows:]

STATEMENT

of

JOHN J. SHEEHAN
Legislative Director of the
UNITED STEELWORKERS OF AMERICA

on the subject of

THE FUNDING AND TERMINATION OF PENSION PLANS

at the Joint Hearing Before the

Subcommittee on Labor-Management Relations
Committee on Education and Labor
U. S. House of Representatives

and

Subcommittee on Labor
Committee on Labor and Human Resources
U. S. Senate

Washington, D.C.
March 24, 1987

On behalf of the United Steelworkers of America, I welcome this opportunity to address the important issues associated with the funding and termination of defined benefit pension plans, and the Administration's proposals for legislative action in these areas. We commend Senator Metzenbaum and Representative Clay for holding these timely hearings, and thank the Subcommittees for the opportunity to present the Steelworkers' views.

The Steelworkers played a leading role in the enactment of the Employee Retirement Income Security Act, the landmark legislation that established minimum vesting and funding standards, as well as fiduciary standards, for all pension plans and that created the federal pension termination insurance program. We are proud of the role that our Union played in that effort and in subsequent efforts, such as last year's Single-Employer Pension Plan Amendments Act, to improve on the pension protections afforded to employees and their families.

The termination insurance program of Title IV of ERISA has been of enormous benefit to retirees, both in the steel industry and in the nation as a whole. The unfortunate fact is that, over the past several years, the domestic steel industry has been in chaos, with a number of steel companies driven to bankruptcy. We are all painfully aware of the LTV Steel bankruptcy, the largest bankruptcy in United States history. That case embraces three steel companies: Jones & Laughlin Steel, Republic Steel, and Youngstown Sheet and Tube. And we have witnessed and lived through the bankruptcies of Wheeling-Pittsburgh Steel and Mesta Machine, both based in Pittsburgh. Continental Steel in Indiana also filed for bankruptcy and subsequently ceased operating, and many of its workers were completely deprived of early retirements when the PBGC terminated the pension plan. Last month, Kaiser Steel of Los Angeles entered Chapter 11. It joined, among others, McLouth Steel of Detroit, Phoenix Steel in eastern Pennsylvania, Eastern Stainless Steel of Baltimore, and Guterl Steel and Roblin Steel in the Buffalo area. I could name many, many other smaller companies, and any number of steel foundries. The length of this list is indeed shocking.

In most, if not all, of these cases, the financial plight of the companies has led to the termination, or the threatened termination, of the companies' pension plans. Where the pension plans have been terminated, the Pension Benefit Guaranty Corporation has guaranteed many -- but by no means all -- of the pension benefits for retirees and their families. I cannot overstate the critical importance of the PBGC's guarantees for employees and retirees in the steel industry, for their families, and for their communities.

While the main focus of today's hearing is on the funding and termination of pension plans, the wave of bankruptcies and the accompanying loss of pension and retiree health benefits in steel and other basic industries cannot be ignored.

For the past six years, we have implored the government to prevent the very kinds of problems we discuss today through the development of an industrial policy. We are aware that the steel industry is in the throes of restructuring, during which time the acceleration of steel imports eroded the industry's ability to respond to the restructuring pressure. As a result, a chaotic course has been followed as capacity is being reduced in a nonefficient manner. But more than that, there has been an unbelievable toll on workers, retirees, and their communities. While belated action was taken against the onslaught of dumped and subsidized steel that robs American of their jobs and retirement security, it has been inadequate and the unrestrained restructuring proceeds without any rational consideration of the consequences.

To address the pension problems confronting the American industry, Congress must adopt, among other more comprehensive measures, forceful trade legislation. The devastation facing retirees and employers alike, which we describe more fully below, can no longer be ignored.

The Crisis of Early Pension Supplements

Despite the crucial protections that ERISA provides, the fact remains that there is a crisis for tens of thousands of steel industry retirees and their families. That crisis is not addressed by the Administration proposal. That crisis involves early pension benefits.

In the steel industry, the wave of plant shutdowns left many, many workers jobless, and has qualified tens of thousands of workers under age 62 for early pensions. Every one of these individuals would have preferred to work for a full income, but was forced on a pension well before eligibility for Social Security. At LTV alone, there are almost 8,000 early pensioners.

With this problem in mind, the early pensions in the steel industry were designed to pay pension "supplements." These are payments -- usually $400 per month -- for early retirees who lose their jobs, through no fault of their own, as a result of plant shutdowns, job reductions, extended layoffs, or permanent disability. These supplements are added to an individual's basic monthly pension until he or she qualifies for Social Security, usually at age 62. Like Social Security, the supplement is an essential part of the early pensioner's basic income.

Today's crisis arises because the PBGC does not guarantee the $400 supplements. Early retirees whose pension plans have been terminated are thus faced with the loss of $4,800 of their annual income. The loss of these special supplements, by people who have already lost their jobs, is nothing less than tragic.

Allow me to give but a few examples. One man in Aliquippa, Pennsylvania, a married father of five, had been on long-term layoff. He found that even with 27 years seniority, he could no longer hold a job with LTV. After depleting his life savings and selling the family's only car, he finally accepted early retirement. Before the PBGC's recent termination of the LTV pension plans, his monthly income was $950, which he supplemented with food stamps. The loss of the supplement reduced his monthly income to $550, and he has been forced to go on welfare.

Another LTV retiree and his wife, both in their late fifties, have had their monthly income reduced to $267. They find that rent and food alone cost them more than $270 per month, and they are now living off the local union food bank.

Thousands of LTV, and other steel company, retirees have had their monthly incomes similarly cut by one-third, one-half, or more.

Even more tragically, one Youngstown, Ohio retiree, anxious about his continued health insurance coverage and worried about the loss of his monthly supplement of $400, was driven to suicide. This fifty-nine year old man, who worked more than thirty-five (35) years in the steel industry, received a net monthly income, including his supplement, of $622. He worked part time to supplement his LTV Steel pension. Fearful of losing his supplement, he sought and was denied food stamps, household assistance and general relief. His life was destroyed by his anxiety over the loss of retirement income and health insurance. Human tragedies of this sort, reminiscent of the Great Depression, have no place in our society. We fear that, if no relief is forthcoming, there may be other retirees who feel they have no other option but to end their lives.

The Steelworkers have attemped to alleviate the financial hardship for its retired members that results from the loss of pension supplements and other non-guaranteed benefits, including benefits, such as future early or disability retirement benefits, lost by active employees. The Union has negotiated with employers to create new pension plans, known as "follow-on programs," that will pay at least some of the amounts that were lost when the companies' defined benefit pension plans were terminated and the monthly benefits reduced. The PBGC, however, has condemned these programs. Without justification, it has taken the position that, if such follow-on programs are implemented, it will undo the termination and restore the company's pension plans, reimposing the terminated plans' unmanageable liabilities on these bankrupt employers.

Wheeling-Pittsburgh and the Steelworkers have thus been forced to file suit against the PBGC in the Western District of Pennsylvania, seeking a declaration of their right to establish a Follow-On Program to assist present and future retirees who have been injured by a plan termination. And, at LTV -- after the PBGC itself terminated the pension plans without even informing the Union of its intention -- the PBGC has now objected to the Union's efforts to enforce its collective bargaining agreement with LTV, which independently requires the payment of pension supplements. Again, the PBGC threatens to "un-terminate" LTV's pension plans if any relief is provided to retirees, only a few weeks after the PBGC's sneak attack on the LTV pension plans created those very hardships.

Nothing in ERISA supports the PBGC's position. We believe it clear that ERISA's guaranteed benefit levels were intended as a floor, not a ceiling, on pension benefits. Congress intended those guarantees to protect employees and retirees, not to punish them. Moreover, nothing in ERISA forbids, or even suggests that it is improper, for an employer, in cooperation with its employees' bargaining representative, to attempt to pay promised pension benefits that exceed the PBGC's guaranteed levels.

At Wheeling-Pittsburgh, for example, the Steelworkers have negotiated a new pension program that is paid for by the agreement of active employees to accept $1.05 per hour less in wages. These contributions fund both a future service defined contribution plan for active employees and a Follow-On Program which is designed to make up for some, but not all, of the losses incurred by retirees and employees as a result of the termination of Wheeling-Pittsburgh's defined benefit plans. Both pieces of the new pension program are defined contribution plans, and therefore are not covered by Title IV's termination insurance program. The new pension program is funded entirely by the agreement of active employees to give up, unselfishly, a portion of their present wages in order to fund a retirement program both for themselves and for their already-retired colleagues. Thus, this Follow-On Program will impose no cost on the PBGC. At bottom, the Follow-On Program would promote what we understand to be Congress' paramount purpose in enacting ERISA -- the assurance that employees with long years of service realize the pension benefits that they had been promised.

As I have said, the legality of the Follow-On Program at Wheeling-Pittsburgh and the Steelworkers' suit to compel LTV to abide by its collectively bargained pension promises are presently the subject of litigation. The courts will determine the employees' and retirees' rights under existing law. The Administration's proposal, however, suggests for the first time that an employer be prohibited from establishing any retirement program, within five years after an underfunded defined benefit plan is terminated, if the new program is designed to make up benefits lost as a result of the old plan's termination. While the exact strictures of the Administration's proposal are still unclear, the Steelworkers are unalterably opposed to any amendment to ERISA that would compel retirees and employees to accept only the benefits which PBGC guarantees, and that would prevent the Union from negotiating with an employer to make up, in whole or in part, for its broken pension promises. No such provision presently exists in ERISA. And, we submit, such an amendment would be directly contrary to ERISA's paramount purpose -- to provide income security to retired employees and their families, and to protect the pension commitments that have been made to those employees.

Of course, rejection of the PBGC's misguided position regarding follow-on programs will provide, at best, only a short-term remedy for a part of this problem. The real solution to the pension crisis now being suffered by tens of thousands of steel industry employees is to guarantee these early retirement benefits under Title IV of ERISA. As we have stated, the employees who qualify for these early pension benefits have lost their jobs through the unforeseen tragedies of plant closings, job reductions, extended layoffs, and disability. These $400 per month supplements form only a fraction of the total liability of any steel industry pension plan. Nevertheless, the supplements, which are paid until the employee can qualify for Social Security, are a crucial part of their retirement income. If ERISA's ultimate purposes are to be achieved and the pension promises to tens of thousands of employees are to be fulfilled, these benefits, too, must be guaranteed.

The Steelworkers recognize that special provisions concerning funding will be needed if these benefits are to be guaranteed. Alternatives include requiring an employer to fund these benefits on an estimated basis, based on honest projections of the likely number of qualifying events in the near future, or requiring the funding of these benefits on a pay-as-you-go basis, thus imposing the funding obligation at the time the employer actually closes or idles a facility.

I have addressed at some length a specific pension crisis confronting tens of thousands of steel industry retirees. The Steelworkers sincerely appreciate the Subcommittee's attention to this critical social problem, and look forward to working with Congress to fashion appropriate legislative solutions. Only through that process will the pension expectations of the nation's working men and women be truly protected.

Let me turn my attention now more directly to the Administration's proposals in the areas of pension plan underfunding, plan terminations, and employer access to pension plan assets.

Pension Plan Underfunding

As the members of these Subcommittees are well aware, underfunding of defined benefit pension plans has been a problem for some -- although by no means all -- employers in the steel industry. While ERISA's minimum funding standards have been successful in many instances, they have fallen short of assuring adequate funding of all defined benefit plans.

Even prior to the last five years of depression in the steel industry, some steel pensions -- like those in other industries -- were underfunded because the minimum funding standards were lenient. Actuaries, who in large part determine a company's required annual contributions, may have been given too much discretion. Seemingly small changes in assumptions regarding interest rates, investment experience, or retirement expectations can have dramatic effects on actual funding obligations. All too often, actuaries were willing to use overly optimistic assumptions in order to reduce their client's annual funding obligations.

At the same time, the statutory timing for making pension contributions encouraged a lax attitude toward funding by some companies. Because pension obligations were paid in a once-a-year "balloon" payment, which only came due some eight and a half months after the end of the plan year, the annual funding obligation could be regarded as something other than a "real" bill. Some steel companies, especially those with cash shortages, met all of their other bills and left the pension bill for last. Companies rarely set aside money over the course of the year to assure that the proper amount would be available when the pension bill came due. And, when the funding obligation did come due, the cash sometimes wasn't there. These companies then turned to the Internal Revenue Service for funding waivers, which increased the present underfunding of the defined benefit plans.

Then, of course, the crisis in steel hit. It is a crisis of world overcapacity, and has produced the double bind of rapidly shrinking markets and falling prices. The result has been the well-known wave of plant shutdowns, bankruptcies, and forced joblessness to which I have previously referred. The cash shortages that followed have meant, for some companies, an inability to meet even the existing minimum funding standards. More companies have sought and received 15-year funding waivers. Often, the companies defaulted even on these waivers, only to leave their pension plans that much more underfunded.

Some legislative changes are certainly in order. Too many retirees and employees have seen their pension promises broken. Pension benefits must be appropriately funded to avoid the tragedy of lost retirement income. But Congress must be careful that the establishment of stronger pension funding standards does not create undue economic hardships for already troubled companies. That result would benefit no one, not the troubled companies, not the PBGC, and -- most importantly -- not the pension plan participants. Thus, in establishing pension funding standards, Congress must follow a balanced approach, one which will adequately protect the benefit expectations of workers, but does not disrupt the defined benefit pension system, as we think the Administration's proposal would do.

While more rapid funding of pension liabilities may be one approach, the Administration's proposal causes us great concern. The proposed amortization periods of three to five years are such a drastic change from present law that many of the nation's more troubled employers might be unable to maintain their present pension plans.

It may be appropriate to apply different funding standards to new liabilities, which are created after the enactment of this legislation. Such a prospective application would limit the adverse impact on existing underfunded plans, yet would help avoid the creation of future underfunded liabilities.

Another possibility which the Steelworkers support is an industry-specific approach, addressing not only pension funding problems, but the costs of retiree insurance as well. The onslaught of imports has already affected, for example, the steel industry, and threatens others. Revenues could be raised through a duty on imports and dedicated to funding the pension and health insurance promises made to retirees and employees. While a detailed mechanism remains to be developed, we believe that this approach more fairly addresses a wide-ranging social problem, rather than shifting the burden solely to the retirees and employees themselves, struggling employers or the PBGC.

The Steelworkers are also concerned about the Administration's proposals regarding the availability and amortization of funding waivers. While changing the timing of a waiver request and considering the financial circumstances of the controlled group may be appropriate, the Administration's suggested standards for granting a waiver and paying it back are unduly restrictive. Such changes would often eliminate the beneficial effects of funding waivers. The Single-Employer Pension Plan Amendments Act has already given the Internal Revenue Service useful new tools to apply in the funding waiver process, including the requirement that in certain circumstances an employer provide security for a waiver. In our view, these changes should be given an opportunity for meaningful application before further restrictions are imposed.

The Steelworkers believe that other legislative changes contained in the Administration's proposal are in order. Actuarial assumptions should be carefully scrutinized, so as to prevent the intentional underfunding of pension plan obligations. We agree that pension obligations should be funded on a more current basis. The Administration's proposal of quarterly funding, with the total annual obligation being paid no more than two and a half months after the end of the plan year, makes good sense. We also support the principle of a cash flow test, in general requiring that annual contributions to an underfunded plan exceed benefit payments and expenses for the year. The Steelworkers endorse the proposition that each member of the employer's controlled group should be jointly and severally liable under the minimum funding rules with respect to each ongoing defined benefit plan. Finally, the Steelworkers agree that tax deduction limits should be revised to allow an employer with an underfunded pension plan to contribute in excess of the otherwise applicable deduction limits. It simply makes no sense as a matter of pension policy to punish an employer that seeks to improve the funding of its underfunded defined benefit plans.

In each of these areas, we look forward to seeing, and to assisting in the development of, proposed statutory language.

The goal of all changes in this area must be to improve the funding of underfunded pension plans. As we have already noted, industry-specific solutions also may be appropriate. In considering this critical area, however, an appropriate balance must be found so that the survival of employees and pension plans is not undermined.

Plan Terminations

The Steelworkers wholeheartedly endorse the Administration's proposal to make employers fully liable for all promised pension benefits, both under standard and distress terminations. The paramount purpose of ERISA is to protect employees' and retirees' expectations in their pension benefits. That purpose is best served if an employer is liable not only for its "benefit commitments," as defined in present law, but for all pension benefits that had been promised.

In addition, the Steelworkers believe that any legislative changes in ERISA must address the PBGC's deficit. Whenever a plan becomes underfunded and then terminates (despite improved minimum funding standards), and whenever an employer is unable to pay all promised benefits (despite increased employer liability), the PBGC must be able to provide the necessary pension insurance for retirees and their families.

The PBGC's present premium is too low. Even though it was recently increased, it remains at only $8.50 per employee per year. The long-term PBGC deficit, already in excess of four billion dollars, must be addressed in any pension legislation considered by the Subcommittees.

The Steelworkers support an increase in the PBGC premium, and we would support provisions for additional, annual premium increases or a permanent indexing of the premium. However, the PBGC has, in recent months, suggested modifying the premium structure by establishing a variable or risk-related premium. That concept, which is not yet a legislative proposal, is strongly opposed by the Steelworkers. This proposal could drastically increase the premiums of employers who are least able to shoulder that burden.

The PBGC was created by Congress to protect the pension promises of millions of workers. And, if the nation chooses to allow its industrial and manufacturing base to decline, a choice with which we vehemently disagree, the costs of economic restructuring should not be borne solely by the employees, retirees and the companies which employed them. The recent surge of pension plan terminations is one symptom of restructuring, and the cost of curing the financial problems of PBGC must be shared by all.

Employer Access to Plan Assets

In its proposal, the Administration seeks to address the problem of plans with so-called "excess assets," plans which at a given point in time have assets greater in value than the present value of accrued benefits. This proposal is flawed, however, because it is based on the erroneous assumption that the money held in these tax-exempt trusts, which are dedicated to provide retirement benefits to employees and pensioners, belongs to the employer.

It is the Steelworkers' position that the contributions made to pension plans belong to the plan participants, both active and retired, not the employer. In bargaining, for example, a part of the cost of any economic package is the contributions made to provide pension benefits. To obtain improved pension benefits, workers forego current income or other fringe benefits. The deferred compensation aspect of pension contributions is best illustrated by a situation where the Steelworkers and employer agreed to a fixed hourly contribution to a defined benefit pension plan. After a period of time, the collectively bargained funding mechanism was altered to eliminate the required contribution, permitting the employer to contribute only the amount the law required. No contributions were needed after the change because the plan was "overfunded," and remained so. The employer later sought to recapture the excess, and the Steelworkers opposed the improper seizure. The fundamental unfairness of the Administration's proposal which provides the employer with the excess is strikingly obvious. Those employees who gave up current wages in exchange for a well-funded future pension would be deprived of their bargain. Their deferred wages would be appropriated for the use of the employer. Even leaving a "cushion" in the plan may not provide adequate protection. If a withdrawal were made and a business reversal occurred shortly thereafter, the plan could be without adequate assets to provide the expected benefits.

In reality, these "excess pension assets" do not represent excessive or mistaken employer contributions; rather, they represent, to a large degree, higher than expected investment returns, caused by inflation and unusual short-term market conditions. That this is so is confirmed by a recent study of the Employee Benefit Research Institute. This study showed that the asset growth of pension funds in recent years resulted from investment returns, not contributions.

The evanescent nature of pension surpluses is well illustrated by the Steelworker's recent experience with a so-called surplus asset situation. Public filings for the corporation showed excess pension assets in the billions, using an interest rate of 9% to value pension liabilities. Upon closer examination, we learned that this figure combined a number of plans maintained by the employer and its wholly-owned subsidiaries, and that the supposed surplus attributable to the contracting employer's plan was in fact half of the reported amount. More significantly, ten months after the filing of these corporate reports, a decrease of 1% in the interest rate, reflecting subsequent market conditions, wiped out almost 60% of the surplus. Permitting withdrawals from ongoing plans, whose liabilities may fluctuate with each swing in the market, jeopardizes the benefit security of plan participants.

In formulating legislation, the Steelworkers propose that neither reversions upon plan termination nor withdrawals from ongoing plans be permitted. Plan assets should remain available to improve the benefits payable to participants, particularly those paid to retirees and to protect these individuals from the ravages of inflation. Without inflation protection, participants in defined benefit plans see the real value of their benefits deteriorate because of increasing prices. Ironically, the same higher interest rates, which so hurt participants and beneficiaries, generate high investment returns and surplus assets which employers now seek to obtain. In effect, when a reversion occurs, workers and retirees subsidize the employer at a time when they can least afford it.

This result runs contrary to the principle that the assets in a pension fund are "owned" by the workers and retirees and are for their benefit. Workers who gave up wage increases in exchange for employer pension contributions end up receiving less than the wages deferred. It is this fundamental structural injustice which must be addressed, not exacerbated as the Administration proposal would do.

The need for improved retiree pension benefits, particularly during periods of inflation, cannot be overstated. The usual argument against increasing pension benefits is its high cost. But, if assets remain in the plan, benefits may be improved without necessarily increasing the employer's contribution. This is so because of the impact of inflation on pension costs. Inflation can decrease employer contributions to a defined benefit plan in both real and nominal terms. If inflation gives rise to earnings higher than were predicted by the actuary, the plan will become overfunded, and the employer can reduce his contributions nominally. The decreasing value of a unit of currency due to inflation reduces the value of this contribution in real terms further still. Even if the investment performance of the fund is not favorable and the employer cannot reduce his costs nominally, inflation can still reduce the value of his costs in real terms. By prohibiting withdrawals or reversions of excess assets, pension reform would recognize that the inflation component belongs to plan members and should be used to protect their benefits.

One troubling aspect of the Administration's proposal is the concept that assets from a terminated pension plan, or a plan transferred in a business transaction, would be moved to other plans maintained by the employer or other members of the controlled group. The injustice of this proposal is illustrated by our prior example of the collectively bargained contribution. Instead of seeing their deferred compensation used to provide pension benefits, the employees would be subsidizing other workers.

Yet another concern the Steelworkers have with the Administration's proposal is the effect it might have on the continued existence of defined benefit pension plans. There is no limit on the amount of a reversion an employer may obtain if it ceases to maintain any defined benefit plans. The penalty of 10% excise tax plus current income tax may be a small price to pay to recapture millions of dollars. Moreover, the proposed five-year ban on the establishment of defined benefit plans serves little purpose, other than to deprive employees of adequate pension income. Indeed, taken in combination with permitting a full reversion, the five-year ban is an invitation to establish defined contribution plans as permanent features, thus affording more limited retirement protection to employees.

One aspect of the Administration's proposal which the Steelworkers can support in principle is the idea of an incentive for the pre-funding of retiree health and life insurance benefits, so long as the only time pension assets may be used for this purpose is upon the termination of a pension plan.

The importance of retiree medical insurance cannot be gainsaid. In fact, to the retiree on an early pension with serious medical problems, the insurance is even more precious than the pension. Our members worked hard to win retiree insurance at the bargaining table. The Union has struggled to establish the principle that these health and life insurance benefits last for the lifetime of the retiree and surviving spouse. Today, facing a wave of bankruptcies throughout the steel industry, the Union is working to save these retiree benefits in Chapter 11 reorganizations through its support for the Metzenbaum-Stokes bill, the Retiree Benefits Security Act of 1987.

As the Administration recognizes, health insurance is generally not funded and is not guaranteed as pensions are. The ultimate solution to the problem of unfunded retiree insurance promises may very well entail, in addition to advance funding, some combination of Medicare improvements, a PBGC-type system to guarantee retiree insurance promises, or national health insurance. These reforms will not be won quickly or easily, but in the meantime, consideration should be given to providing appropriate incentives to those employers who have the ability to pre-fund retiree medical and life insurance benefits.

The Administration's proposal permits an employer to use "excess" pension assets to fund retiree insurance, but there is little incentive for an employer to do so. The complex rules of Section 419 of the Internal Revenue Code, which impose stringent limits on pre-funding, must be altered.

There are, however, two (2) problems with the proposed transfer of pension assets to fund retiree health benefits which must be addressed. First, the Administration's proposal limits the group which may benefit to individuals who are retired as of the date of the transfer. The Steelworkers suggest that this limitation is inappropriate since the available pension plan assets are derived from the deferred wages of active employees who will enjoy future retiree benefits as well as those already in pay status. The arbitrary line drawn by the Administration should be eliminated. Second, the proposal does not limit the use of assets to benefit employees and retirees who were covered by the pension plan with the "excess." The Steelworkers suggest that such a limitation is necessary since plan assets should only be used to benefit the individuals covered by the particular plan.

Conclusion

The importance of defined benefit pension plans to the workers and pensioners represented by the United Steelworkers of America, as well as other employees and retirees across the country, is clear. That there are current problems which need to be addressed is apparent to all. As the need for pension reform are considered, Congress must carefully balance the necessary improvements in funding requirements with the goal of preserving defined benefit plans and the employers which sponsor them. The Steelworkers look forward to working with the Subcommittees and other interested parties in shaping appropriate legislation.

Senator **Metzenbaum**. I want to thank the three of you. I have again checked with my colleagues, and we are prepared to waive our questions although we may submit some in writing to you as well as the previous panel.

But I want to say that I noted with interest your testimony, and I kid you not, we have got a tough road to hoe ahead of us, and if management, which is the next panel, or labor, or the administration, or we in Congress bog down in a hard solid position without some willingness to negotiate and compromise, we probably will not have any legislation this session. We in Congress are determined to try to get a legislative package through. We share your concerns, but we also recognize that sometimes, as lawyers have always said, a poor settlement is better than a good lawsuit. And we are going to try to see if we cannot get through a good settlement, so we need to work with you, and we hope you will be working with us and look forward to spending some time with you in the coming weeks.

Thank you very much.

Our next and last panel includes Mr. Robert Hendrickson, corporate director, employee benefits, Sherwin-Williams Co., Cleveland, OH, on behalf of the U.S. Chamber of Commerce—I am happy to welcome a fellow Clevelander—Vance Anderson, Employee Relations Counsel, Mobil Oil Corp, New York, a member of the Board of Directors, Association of Private Pension and Welfare Plans; Michael Gulotta, president and chief actuary of AT&T Co., Actuarial Sciences Associates, Inc., Piscataway, NJ, on behalf of the National Association of Manufacturers; and Robert Stone, on behalf of the ERISA Industry Committee of Washington, DC.

Without objection, your entire statements will be included in the record. Congressman Clay and I are happy to welcome you as well as the other members of this Committee. I think you know the time constraints we are operating under.

Mr. Hendrickson, we will be happy to hear from you first.

STATEMENTS OF ROBERT C. HENDRICKSON, CORPORATE DIRECTOR, EMPLOYEE BENEFITS, SHERWIN-WILLIAMS CO., CLEVELAND, OH, ON BEHALF OF U.S. CHAMBER OF COMMERCE; MICHAEL J. GULOTTA, PRESIDENT AND CHIEF ACTUARY, AT&T CO., ACTUARIAL SCIENCES ASSOCIATES, INC., PISCATAWAY, NJ, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS; VANCE J. ANDERSON, EMPLOYEE RELATIONS COUNSEL, MOBIL OIL CORP., NEW YORK, NY, AND MEMBER, BOARD OF DIRECTORS, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS, AND ROBERT STONE, ON BEHALF OF ERISA INDUSTRY COMMITTEE, WASHINGTON, DC, ACCOMPANIED BY JOHN VINE, COVINGTON AND BURLING, COUNSEL TO ERISA INDUSTRY COMMITTEE

Mr. **Hendrickson**. Thank you, Chairman Metzenbaum, Chairman Clay, and members of the subcommittee.

I am Robert Hendrickson, corporate director of employee benefits for the Sherwin-Williams Co. in Cleveland, OH. I serve as a member of the U.S. Chamber of Commerce's Employee Benefits

Council. I am pleased to appear here at today's hearing on behalf of the Chamber.

I will give a brief summation of the entire testimony which is submitted at this hearing.

The Chamber's perspective on plan funding and the administration's proposal essentially can be articulated in seven points, the background of which is further developed later in this paper.

First, the Chamber believes that the reversion privilege through plan termination as it now stands should not be lost to employers.

Second, the Chamber contends that withdrawal of excess assets in overfunded plans should be permitted, but with a cushion, that cushion not more than 20 percent of the excess assets over current benefit commitments. Otherwise, burdensome restrictions that have been proposed make the withdrawal option unattractive to employers.

Third, the Chamber is concerned that the cumulative effect of the proposals will be the termination of defined benefit pension plans and the discouragement of the establishment of new plans.

Fourth, the Chamber contends that excess assets should be allowed to be transferred on a tax-free basis at the employer's option, to fund health care benefits for both current and future retirees.

Fifth, the Chamber favors modification of minimum funding rules to improve the funded status of plans that are currently underfunded on a benefit commitment basis, that commitment basis being effective on the date of termination or asset withdrawal.

Sixth, the Chamber supports a policy of no continued benefit accruals or benefit increases during a time that a plan is underfunded.

Seventh, while the Chamber commends the administration's goal of improved funding and termination conditions, we have reservations about the effect of the actual proposals. The Chamber is troubled by the emphasis on the "controlled group" concept which permeates these proposals. We believe this is unnecessary for the protection of plan participants and unduly complicates the entire funding, termination and business management process.

Thank you for the opportunity of speaking.

Senator METZENBAUM. Thank you, Mr. Hendrickson. We appreciate it very much.

[The prepared statement of Mr. Hendrickson follows:]

STATEMENT
on
PENSION PLAN FUNDING
before the
SUBCOMMITTEE ON LABOR
of the
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES
and the
SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
of the
HOUSE COMMITTEE ON EDUCATION AND LABOR
for the
U.S. CHAMBER OF COMMERCE
by
Robert C. Hendrickson
March 24, 1987

Chairman Metzenbaum, Chairman Clay and members of the Subcommittees, I am Robert C. Hendrickson, Corporate Director, Employee Benefits for the Sherwin-Williams Company in Cleveland, Ohio. I serve as a member of the U.S. Chamber of Commerce's Employee Benefits Council. I am pleased to appear at today's hearing on behalf of the Chamber. Accompanying me is James A. Klein, Manager, Pension and Employee Benefits for the Chamber.

THE IMPORTANCE OF WELL-FUNDED PENSION PLANS

Responsible funding of pension plans is a practice that benefits everyone. Clearly, the retirement income security of employees and retirees is served best by private pension plans that are well-funded. The interests of employers, too, are met by well-funded pension plans. A well-funded plan helps a particular company to assure its employees that the pension promises made to them will be fulfilled. In addition, businesses in general--the vast majority of which responsibly fund their pension plans--have a significant interest in policies that require all sponsors of defined benefit plans to fund their plans adequately. After all, it is employers that bear the burden of financial support of the Pension Benefit Guaranty Corporation's (PBGC) termination insurance system; and, the employers that remain within that system prefer not to pay for the retirement benefits of other firms' employees.

Ultimately, it is the American public whose interests are served by well-funded private pension plans. Not only is a better quality of life and economic prosperity fostered by a financially-secure elderly population, but also the American taxpayer is better off when the private pension system is

financially able to provide these r
the ones who, in the final analysis,
financially-troubled pension termin [illegible]
retirement income security through greater Social Security expenditures, if private pension plans are funded inadequately.

It is with these interests in mind that the Chamber always has supported responsible pension plan funding--including a number of the reforms to the pension termination insurance system contained in the Single Employer Pension Plan Amendments Act signed into law last year. Therefore, we are especially pleased to share with you our impressions of the Reagan Administration's pension plan funding proposals.

The Chamber's perspective on plan funding and the Administration's proposals essentially can be articulated in seven points, the background of which is further developed later in the statement.

First, the Chamber believes that the reversion privilege, as it now stands, should not be lost to employers.

Second, the Chamber contends that withdrawals of excess assets in overfunded plans should be permitted with a "cushion" of excess assets over current benefit commitments. Other burdensome restrictions that have been proposed make the withdrawal option unattractive to employers.

Third, the Chamber is concerned that the cumulative effect of the proposals will be the termination of pension plans and the discouragement of the establishment of new plans.

Fourth, the Chamber contends that excess assets should be allowed to be transferred, on a tax-free basis, at the employer's option, to fund health care benefits for current and future retirees.

Fifth, the Chamber favors modification of minimum funding rules to improve the funded status of plans that are currently underfunded on a benefit commitment basis, effective on the date of termination or asset withdrawal.

Sixth, the Chamber supports a policy of no continued benefit accruals or benefit increases during a time that a plan is underfunded.

Seventh, while the Chamber commends the Administration's goal of improved funding and termination conditions, we have reservations about the effects of the actual proposals. The Chamber is troubled by the emphasis on the "employer/controlled group" which permeates the proposals. We believe this is unnecessary for the protection of plan participants and unduly complicates the entire funding, termination, and business management process.

OVERFUNDED PENSION PLANS

The Chamber believes that the enormous attention paid to the issue of reversions from overfunded pension plans is grossly misdirected. It is underfunded plans that really should be the focus of attention for Congress and the Administration.

The debate over the disposition of excess funds has turned on the question of "whose money is it?" However, the real issue is and ought to be whether plan participants are receiving the pension benefits promised to them. Very definitely, employers exercising reversions are fulfilling their obligations since they must ensure payment of promised benefits to all plan participants before they may take back a single penny. The reversion, after all, is only of the excess assets. In addition--and this is a point that opponents of reversions tend to ignore--even plan participants who are not vested in a pension benefit of an ongoing plan immediately become vested in the value of their accrued benefit upon a plan termination/reversion.

With respect to the question of whose money is the excess assets--the Chamber firmly believes that it belongs to the employer-sponsor of the plan. The promise that sponsors of defined benefit pension plans make to employees is a promise of certain pension benefits, calculated by a formula. As long as this promise is kept, the excess funds should be available to the employer.

Before Congress undertakes to draft legislation or to respond in detail to the Administration's proposals dealing with overfunded plans, we strongly encourage it to review the history of national pension policy with respect to overfunded plans. The testimony submitted by Peter M. Kelly on behalf of the Chamber to the U.S. Department of Labor ERISA Advisory Council's Termination Task Force is attached (See Appendix). That testimony explains in great detail the deliberate policy enunciated by Congress nearly 50 years ago in establishing a process that permits reversions. The essence of that policy was and is a congressional recognition of the fact that permitting reversions is important in encouraging companies to fund their pension plans responsibly. It also acknowledges that companies that bear the risk of underfunded plans also should have access to excess funds in responsibly funded plans, once all promised benefits are paid to participants.

To restrict reversions unduly is to deny to employers the quid pro quo for the liability they bear to finance their underfuned plans adequately. Ironically, restrictions on reversions actually penalize those employers who have kept their pension promise by responsibly funding their plans.

THE NUMBER OF PENSION REVERSIONS IS DECREASING

Apart from the philosophical and legal bases for not restricting reversions, which are enumerated above and in the Appendix, a very practical reason exists for moving attention away from this issue--there simply are very few companies engaging in a termination/reversion and the pace is slowing.

Of the literally hundreds of thousands of defined benefit pension plans in existence in the years 1980 through 1986, only 1,338 pension plans had terminated with reversions in excess of $1 million.

While the amount of reverted assets in that seven-year period approaches $16 billion, let us put it in perspective: our nation's private pension system has assets of nearly $2 trillion--50 percent of our gross national product. The amount of pension assets reverted over the past several years is a very small percentage of the total money in the pension system.

Moreover, the claims of benefit loss following pension reversions are greatly exaggerated. The PBGC has reported that following terminations/reversions, 70% to 80% of plan participants continue to be covered by identical or superior defined benefit plans. About 5% to 8% of plan participants were left with no successor plan and, in most of these instances, the plan was terminated because the plan sponsor had gone out of business.

Consider this: while total assets reverted since 1980 approximate $16 billion, the total unfunded liability of underfunded plans right now exceeds $45 billion. Is not the attention focused on the wrong issue?

The evidence that the pace of terminations/reversions is slowing down is clear. In 1985, the PBGC reported 525 reversions. In 1986, that number dropped to 194. The chief reasons attributable for this decline are 1) lower interest rates, which have reduced the level of overfundedness of many plans and 2) the 10% excise tax on reversions imposed by the Tax Reform Act of 1986 (P.L. 99-514). Although interest rates may rise again in the future, the excise tax remains and it undoubtedly chills the interest of some companies to take a reversion.

THE ADMINISTRATION'S PROPOSALS ON REVERSIONS AND WITHDRAWALS

The Administration has proposed a number of policy changes with regard to terminations/reversions and has suggested a mechanism for withdrawals from ongoing plans. We wish to address the specifics of these proposals.

The Administration's proposal to allow withdrawals of excess assets is an attempt to balance certain interests: giving employers access to money not needed to pay promised benefits, while avoiding the necessity of an actual plan termination. Some employers may welcome this alternative to obtaining pension assets.

The Chamber believes that a workable withdrawal policy that allows an adequate safety cushion to protect plan particpants' interests and is simple enough to enable employers to use it, would be a positive step. It would enable employers to have access to their funds without requiring the termination of the plan. A cushion of 20% over benefit commitments (a figure suggested by the Department of Labor ERISA Advisory Council's Termination Task Force) seems to us to be an appropriate level. The withdrawal option, however, should not be in lieu of but rather in addition to a continued right of termination/reversion.

Most of the comments that the Chamber has heard from its members have noted that the restrictions on reversions are unnecessary and the withdrawal option, because of all of its costly requirements and undue restrictions, is not really an attractive alternative.

The Administration's focus on the "controlled group" for purposes of determining both the frequency of withdrawals or terminations/reversions, and the amount of assets that may be recovered through a reversion or withdrawal is overly broad. Many companies terminate plans regularly in the normal course of events--not in order to recover excess assets or to shift liability for an underfunded plan to the PBGC. Mergers, acquisitions, sales of subsidiaries, combining plans for ease of administration or to equalize benefits offered to a company's employees are all normal business reasons for a pension plan to terminate. Application of the "controlled group" test for purposes of determining the level of recovery of assets by means of either withdrawal or reversion is overly-cumbersome and does not account for these normal business transactions.

In addition, the Administration proposal to prohibit an employer from reestablishing a defined benefit plan -- for the same employees for five years following a termination/reversion -- can only be viewed as an attempt to discourage terminations/reversions. A study prepared for the U.S. Department of Labor ERISA Advisory Council's Termination Task Force by the Hay/Huggins Company, Inc., in April 1986 showed that among the terminations/reversions studied, the establishment of defined benefit successor plans, either as a result of a "spinoff/termination" or a "termination/reestablishment," was the practice in over 75% of the cases. This common practice is beneficial to plan participantss and no valid purpose is served by restricting it and creating a disincentive to the establishment of defined benefit plans.

Other elements of the proposal also provide disincentives for establishment of new plans. For example, the proposed prohibition of terminations/reversions during the first 10 years of a plan's life will serve only to preclude the establishment of such plans. Again, we note that the basis for congressional support for reversions for the past several decades has been to encourage companies to establish and responsibly to fund them. A common criticism of the current reversion policy is that it fosters plan terminations. We believe that the evidence of the infrequency of terminations/reversions suggests otherwise. However, the Chamber has a genuine concern that the complexities of the proposed reversion/withdrawal mechanisms could encourage employers to abandon the defined benefit plan system altogether or to decide not to enter it. If there is to be a place for defined benefit plans in a vibrant private pension system, incentives--not obstacles--to their creation must be fostered.

RETIREE HEALTH BENEFITS

One positive element of the Administration's proposal is the recommendation to permit the transfer of excess plan assets available for withdrawal to a tax-favored health fund for current retirees.

We should be clear regarding what this proposal is and what it is not. It is not a mechanism to allow employers greater flexibility to pre-fund health benefits for future retirees. That ability was restricted in the Deficit Reduction Act of 1984 and regrettably but understandably unfunded retiree health liabilities have increased. This is a problem that employers and employees alike would like to address in a responsible fashion. The current Administration proposal on retiree health benefits is a modest and positive initiative, which will help to address a portion of the problem of unfunded health benefits for current retirees.

It should be noted that under the proposal the transfer of excess pension assets to a health fund is treated as a withdrawal from an overfunded plan. Thus, unless the withdrawal provisions are made more attractive, very few employers will avail themselves of the transfer mechanism.

There can be no denying that the unfunded retiree health liabilities are real and enormous. Prohibitions or undue restrictions on funding for these liabilities is short-sighted and will result in shifting future health care costs to participants or taxpayers. It would be better for all parties concerned--employers, beneficiaries, and taxpayers--to encourage adequate funding of these obligations by employers.

It is with this thought in mind that we recommend that employers be permitted to have access to excess pension assets on a tax-free basis if the assets are dedicated to retiree health benefits for current or future retirees.

UNDERFUNDED PENSION PLANS

By far the more important issue in pension funding policy is how to improve the status of underfunded plans. This is an issue fraught with controversy, yet vitally important to both the retirement income security of many Americans and to the financial health of several companies. Chamber members are convinced that workable and prudent funding rules are the key to well-funded plans. We support modification of minimum funding rules to improve the funding status of plans that currently are underfunded on a benefit commitment basis effective on the date of termination or asset withdrawal. However, we would oppose other alternatives that are disruptive or overly-burdensome.

In recent years, a number of voices outside the business community have drawn attention away from the problems posed by underfunded plans by focusing attention on terminations/reversions from overfunded plans or by insisting that changes in our international trade policies might solve the problem of underfunded plans.

Fundamentally, we believe that improved funding really can be achieved only by following two steps. First, we must address squarely the deficiencies of pension and tax policy that contribute to underfunding. Second, we must undertake deliberately and cautiously the changes necessary to improve the funding status of pension plans that are underfunded with the least disruption to businesses, plan participants, and the pension termination insurance system.

In order to put the issue of underfundedness in proper perspective, we should start with the recognition that the private pension system is generally in good shape. At the end of 1986, the unfunded liabilities in underfunded plans were approximately $45 billion, according to the U.S. Department of Labor. The excess assets in overfunded plans at the same time were about $263 billion, leaving a net excess of $218 billion in defined benefit plans. As indicated earlier in this testimony, terminations/reversions for the entire period 1980 through 1986 amounted to only about $16 billion. Therefore, one may conclude that the vast majority of plans are both well-funded and continuous. Nonetheless, the $45 billion figure--and the potential financial risk it poses to participants and the termination insurance system--must be considered seriously.

There is some conflicting data as to whether funding has improved or worsened in recent years. Various surveys indicate improved levels of pension funding measured on a termination basis. For example, Greenwich Associates' data regarding 1,500 of the largest corporate single-employer plans show that the rate of pension assets to accrued liability rose from a 70% ratio in 1978 to a 95% ratio in 1985. Likewise, data compiled by the Wyatt Company concerning plans with 1,000 or more participants show that the percentage of plans fully-funded for accrued vested benefits and total accrued benefits has risen steadily from 1979 through 1985. Though the plans surveyed are not necessarily a representative sample of all defined benefit plans in the country, they do include the large-sized plans that are most likely to pose a risk of greater liability to the PBGC if they are terminated or become underfunded.

A different picture was painted by a recent report issued by the United States General Accounting Office (Pensions: Plans With Unfunded Benefits, October 1986), which concluded that the contingent liability to the PBGC insurance program is significant and growing.

Though the studies mentioned above did not necessarily include the same plans, or cover the same periods, they are helpful when viewed in the aggregate. They confirm that most plans are well-funded but that a number are not--and that those plans that are not do pose a growing financial threat to the PBGC. Further analysis of underfunded plans would demonstrate that plans that are underfunded are generally pension plans that provide a "flat dollar benefit"--such as $10 multiplied by the participant's years of service for the employer. This type of plan has been for years the prototype plan for hourly paid workers in the industrialized sector of America--regardless of whether the employees are union or nonunion. As discussed below, current federal policy not only discourages adequate funding of this type of plan but also often prevents plans from being funded adequately. Other types of plans besides flat dollar benefit plans also may be underfunded, and the reasons for those underfunded situations also are discussed below.

THE CAUSES OF UNDERFUNDING

Before one can begin to determine the appropriate responses to the underfunding problem, it is critical to recognize the many factors contributing to this condition.

The first factor often is that an employer is permitted to adopt a plan that provides benefits for employees' prior service, but Section 404 of the Internal Revenue Code does not allow a tax deduction for the adequate funding of such benefits. Typically, when an employer adopts a flat dollar benefit plan, the plan provides benefits for the employees' prior service. This is logical because the plan generally is being adopted to meet the needs of the long-term employees. What is not logical is that even if the adopting employer wants to fund for this past service liability, it is unable to do so and take a deduction for such funding. We note that the Administration's proposal on deductions would cure this defect, and we support this aspect of the proposal.

The second factor is that benefits payable for a flat dollar plan are not based upon the compensation of employees, and the only way for the benefits to increase to reflect inflation or the higher pay levels of the participants is by plan amendment. Typically, plan amendments increasing benefits have been adopted every few years. During the highly-inflationary period of the 1970's, it was not unusual for the benefits under this type of plan to double or triple in a relatively short period.

Under the funding rules, benefit increases must be amortized over a period of 10 to 30 years, even though they will be insured fully by the PBGC in five or fewer years. With pension benefit increases occurring every few years and funding at a rate faster than 10 years effectively prohibited, the flat dollar pension plan never can reach full-funding status.

A third factor is pension plan provisions that trigger benefits upon the occurrence of certain events (e.g., the closing of a facility, the cessation of the employer's business, or the termination of a certain collective bargaining unit). Such provisions frequently are contained in flat dollar benefit plans that typically cover the employees of a certain collective bargaining unit or facility. Since the lifespan of such a pension plan is unpredictable and the plan may cease to exist suddenly, the benefits that are triggered pursuant to the plan's provisions may not be funded when the plan terminates.

A fourth factor is the number of waivers to the minimum funding standards that are granted by the Internal Revenue Service. Funding waivers are by no means necessarily negative. It is important to remember that companies seeking such waivers are often those that might otherwise have to reduce severely or cease operations if the waivers are not granted. Clearly, in such a situation, massive layoffs or cessation of business operations pose a more serious danger to the well-being of the company's employees and to the pension termination insurance system than the granting of a funding waiver. Nonetheless, numerous waivers can diminish a plan's funding status with potentially greater adverse consequences when the plan ultimately terminates.

The Chamber is pleased that among the reforms to the single employer pension termination insurance system that were enacted as part of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) is a requirement that the PBGC (which bears the risk of underfunded plans) be notified when the IRS receives a funding waiver application. Moreover, under COBRA, the IRS is permitted to require "security" as a condition of granting funding waivers.

Related to the issue of funding waivers is the fact that benefits continue to accrue and benefit increases are sometimes granted during periods when funding waivers are in effect. This can be problemmatic. If the employer cannot afford to make contributions for benefits that have been accrued under the plan, it may not be in a financial condition to incur even greater unfunded pension liabilities. Freezing accruals and halting benefit increases at a time when a funding waiver is permitted might lessen the impact of mounting liabilities at a time when the ability to fund a plan is tenuous.

A fifth factor is federal legislation that mandates benefit increases. The provisions of the Retirement Equity Act that require joint and survivor benefit options in all plans diminish the funding status of plans. Likewise, the provision of the Tax Reform Act that requires five-year vesting will diminish their funding status. Similarly, the new so-called nondiscrimination rules contained in the Tax Reform Act, by forcing coverage of additional groups of employees, will have a negative impact upon funding levels. The Chamber absolutely believes that pension plans should not discriminate, that the vast majority of plans do not, and that these proposals to change the nondiscrimination rules were unnecessary and precipitous.

THE ROLE OF FUNDING STANDARDS

The minimum funding standards of ERISA were intended to ensure that pension plans do not become dangerously underfunded. Certainly, for the most part, they have been successful. However, in the case of the flat dollar benefit plan, the funding standards actually inadvertently encourage underfunding. For example, the period for funding past service accrued benefits is 30 years, while the same benefits become insured by the PBGC in five years. The 30-year funding rule certainly was appropriate for benefits that were accrued prior to the adoption of ERISA. Employers needed that length of time as an incentive to maintain plans and to provide benefits for prior years of service. Likewise, since the enactment of ERISA, plans have been adopted or benefits have been increased on the assumption that these benefits will be funded over a 30-year period.

The Administration now is proposing a faster schedule of funding for underfunded plans. The Chamber favors modification of minimum funding rules to improve the funded status of plans that are currently underfunded on a benefit commitment basis, effective on the date of termination or asset withdrawal. This is fundamental to improving the financial stability of plans and protecting the retirement income security of plan partcipants.

Critical to requiring more rapid funding is ensuring that the funding is not so precipitous that it creates undue financial burdens on the companies involved. At the very least, rational and workable transition rules are needed for companies that have complied with current law in making their funding decisions. We have seen, time after time, that legislative changes that are too costly to implement and inconsistent with corporate expectations have a negative effect on the willingness of employers to continue or to establish pension plans.

We already have commented on the careful approach that the Chamber believes must be taken with respect to funding standards. An additional point should be noted. As in the discussion on overfunded plans, we maintain that the liability of the controlled group members, for application of the minimum funding rules to each ongoing defined benefit plan, is overly-broad. It does not account for the myriad reasons that different plans of the same employer/controlled group may have different funding status.

Other components of the Administration's proposal also deserve discussion. Some tightening of the frequency of minimum funding waivers may be in order. However, the Administration's plan to permit waivers only during "temporary hardship" is not clear. The ultimate definition of temporary hardship would dictate whether qualifying for that status is so difficult to achieve that the purpose of granting a waiver is undermined.

The Chamber supports the proposal liberalizing the deduction for a contribution in excess of otherwise applicable contribution limits. Within the parameters of expanded deductions that are financially prudent, given federal budget deficit considerations, the encouragement of additional funding would aid the cause of fuller funding.

The proposed changes in employer liability in the event of termination require scrutiny. The Administration is proposing that insufficiently-funded plans could not terminate, unless the employer and controlled group satisfy the criteria for a "distress" termination. The Chamber is proud of the positive role that it played in encouraging some of the reforms of the Single Employer Pension Plan Amendments Act. While we certainly are not pleased with all of the enacted changes, the development of the concept of a distress termination is an improvement over prior law. Not only does the Administration proposal require the applicability of the distress test on an employer/controlled group basis, but also the liability itself in a distress situation would be increased from the current law percentage of benefit commitment test to the full amount of a plan's unfunded termination liability. These new requirements simply seem too draconian in the absence of any evidence that the distress classifications--enacted only last year--are not workable.

Again, we repeat, the focus on the controlled group, for purposes of requiring inter-plan transfers of assets in the event of a termination is an unwise encumbrance on the pension system and discourages plan establishment. Worst of all, it is subject to misuse by employers and employee groups. For example, a group of employees covered by a particular plan offered by the employer/controlled group might negotiate for higher benefits—even if the benefits cannot be funded adequately--since other well-funded plans of that employer/controlled group will have to bear the risk for the underfunded plan. Ironically and unfairly, the employees who choose to forego higher benefit promises in exchange for more secure but lower levels of benefits, actually will subsidize more generous benefits for other workers who are less concerned with adequate funding. To some degree, this kind of cross-subsidization already exists within the framework of the current termination insurance system. It should not be fostered within an employer/controlled group.

CONCLUSION

The above matters are but a few of the myriad issues that arise in considering changes to the laws governing pension plan funding. The issues are fraught with complexity, and the implications for retirees, companies and taxpayers are great. We pledge to work closely with the Subcommittees to analyze the Administration's proposals and we appreciate the opportunity to present our views to you.

APPENDIX

TESTIMONY

on

PENSION REVERSIONS

before the

TERMINATION TASK FORCE

of the

ADVISORY COUNCIL

on

EMPLOYEE·WELFARE AND PENSION BENEFIT PLANS

of the

DEPARTMENT OF LABOR

on behalf of the

CHAMBER OF COMMERCE OF THE UNITED STATES

by

Peter M. Kelly

January 13, 1986

My name is Peter M. Kelly. I am a partner in the law firm of Bell, Boyd & Lloyd. I am based in that firm's main office in Chicago, Illinois, and head the firm's employee benefits group. I also chair the Reversion Task Force of the Employee Benefits Council of The United States Chamber of Commerce. I appear before you on behalf of The Chamber of Commerce of the United States to express the Chamber's views on the subject of the reversion to employer sponsors of assets remaining in terminated defined benefit pension plans following full satisfaction of promised benefits. I am accompanied by James Klein, the Chamber's Manager of Pension and Employee Benefits.

For the reasons set forth in detail below, the Chamber is concerned about repeated efforts to overturn the time-tested principle that employers who prudently fund their defined benefit pension plans and keep their pension promises should be allowed to recover any assets remaining after a plan termination. This principle has been a key element of our national pension policy for at least 48 years and has provided an environment which is conducive to employer voluntary creation of pension entitlements.

By prudently funding its plan, an employer entitled to a reversion has successfully avoided the dangers to itself, its shareholders, its employees and to the termination insurance system which are implicit in the maintenance of an underfunded plan. In addition, by complete funding of benefit entitlements such an employer has fulfilled its pension promises. As such plans reach the end of their life cycles, the employers maintaining those plans only seek what is their due when they recover excess asset reversions. The reversions which they receive and include in taxable income represent the flip side of the risk they previously took. They were obligated to make up any shortfalls during the life of the plan. Now they only seek a return of what is theirs.

I. Current Rules

We suggest that your study should begin with a restatement of the existing rules and the national policy implicit in the current status quo.

A. Defined Benefit/Defined Contribution Distinction. In the debate over pension plan terminations a fundamental point is sometimes obscured. There is a significant difference between pension plans of the defined benefit variety and other forms of employee retirement plans (defined contribution plans). Under each type of plan the rewards of better than expected investment performance goes to the party that bears the risk of investment losses.

Employer contributions to a defined benefit plan are in effect a down payment on each participant's fixed or determinable retirement benefit. In an ongoing plan, participants are entitled to receive the benefit provided in the plan even if due to investment losses or other adverse actuarial experience the cost of that benefit is greater than the participant's proportionate share of plan assets. Any such shortfall, if not offset by subsequent favorable experience, must be made up through future increases in the employer's contributions. Thus, employees know they will receive no more nor less than the plan formula benefit and are relieved of the risks of investment or other plan losses. These risks fall upon the employer who is obligated to make the required pension contributions which together with investment earnings will be sufficient to meet the pension promises contained in the plan. If plan assets are insufficient such employers must contribute additional funds from current earnings or other company assets to fund that insufficiency.

An employer's contributions to a defined contribution plan (e.g., a profit sharing or money purchase pension plan) are irrevocable. The benefits of plan investment earnings and the risk of plan investment losses rest solely upon the employees. Plan participants will receive at retirement whatever level of benefit may be purchased with their account balances. If investment performance is better than expected the employee will receive a greater than otherwise expected retirement income. If earnings are less than expected the employee not the employer bears that risk.

The tradeoff between a defined benefit and defined contribution plan may be expressed as follows: The employee in a defined benefit plan has security regarding the level of benefits to be provided whereas the employee in a defined contribution plan is at risk with regard to the level of benefits. The employee's benefit is backed by the company that sponsors the plan, by the minimum funding standards and the Pension Benefit Guaranty Corporation ("PBGC").

As recent history has clearly revealed, the PBGC guarantee is not complete protection. The primary protection of employee expectations is the promise of the employer to make the required contributions. In return for accepting the risk of providing employees this protection, the employer retains the right to recover any extra assets remaining following full satisfaction of plan liabilities. In an ongoing plan this translates into the potential that future contributions may be reduced if earnings or other plan experiences are better than expected. However, in a terminating plan this is reflected in the right of the employer to recover the excess assets as taxable income.

B. Origin and History of the Current Rules. Most retirement plans are no more than a generation old. The period of explosive growth of qualified retirement plans began in the 1950's and has continued until the present time. Prior to the 1950's Congress gradually developed a series of qualification requirements and other rules which employers have relied upon.

The fundamental rules and policies which gave rise to the explosive growth in plans have not changed in 43 years. They have served us well. These rules have stood the test of time, including the intense scrutiny of two Presidential commissions and the major Congressional restructuring of other aspects of plan operations which was reflected in the Employee Retirement Income Security Act of 1974 ("ERISA").

1. Pre-1950 Period. The provision now incorporated in Section 401(a)(2) of the Internal Revenue Code has its origin in the legislative history of Section 219(f) of the Revenue Act of 1921. That Section for the first time granted tax exempt treatment to a trust established by an employer to provide retirement

benefits. The bill as reported by the Senate Finance Committee required that the trust be irrevocable. Sen. Rep. 275, at 16, 67th Cong., 1st Sess. (1921), Seidman, Seidman's Legislative History of Federal Income Tax Laws, 1938-1861 at 850-51 [hereinafter Seidman].

A Senate floor amendment deleted this requirement. The record of the debate reveals that the Senate was aware that this change permitted revocable trusts to qualify for tax exemption. 61 Cong. Rec. 7113, Seidman at 851.

Section 165(a)(2) of the Revenue Act of 1938 provided express statutory authority for reversion of excess assets remaining in a terminating plan. The language of that Section is virtually identical to the current provision of IRC Section 401(a)(2). This language was added by the Senate Finance Committee to a House Ways and Means Committee provision which would have prevented any use of trust assets for any purpose other than providing benefits to the employees. H. Rep. 1860, at 46-48 and Sen. Rep. 1567, at 24, 75th Cong., 3d Sess. (1938), Seidman at 86-87. The House receded to the Senate position in the conference committee deliberations. H. Rep. 2330, at 45, 75th Cong., 3d Sess. (1938), Seidman at 87.

The 1938 Senate Finance Committee Report contains the following description of the reversion provision:

> This section of the House bill relating to the exemption from tax of employees' trusts, is retained in the bill, except with a change which is deemed advisable in fairness to employers. Under the House bill an employees' trust..is not exempt from tax if it is possible at any time for any part of the trust principal or income to be used for, or diverted to, purposes other than the exclusive benefit of employees. However, it is quite possible that after satisfaction of all pension liability under the trust, an additional amount of funds of the trust will remain, due to erroneous actuarial computations during the previous life of the trust. It seems desirable to allow the employer to provide for the return of such an amount in the trust without the trust losing its exempt status in Section 165. Of course, under the provisions of Section 23(p), the amount recovered by the employer must be reported by him as income. Accordingly, Section 165 of the reported bill provides that an employees' trust will be exempt from tax if at any time before the pension liabilities with respect to employees under the trust have been satisfied, it is impossible for any part of the trust fund, including principal and

> income, to be used for, or diverted to, purposes other than the exclusive benefit of employees. Sen. Rep. 1567, at 24, 75th Cong., 3d Sess. (1938), Seidman at 87.

Excess asset reversions were again considered in conjunction with the Revenue Act of 1942. Although the prior acts did not expressly require the employees' trust to be irrevocable in order to be tax exempt, the report of the Ways and Means Committee Report included a statement that irrevocability was a requirement for tax exemption under the 1938 Act. H. Rep. 2333, at 50, 77th Cong., 2d Sess. (1942), Seidman at 2099. In addition, the House passed version of that bill would have amended Section 165(a)(2) to remove the employer reversion provision. _Id_. at 103-105, Seidman at 2100.

The bill passed by the Senate restored the asset reversion provisions. Sen. Rep. 1631, at 136-138, 77th Cong., 2d Sess. (1942), Seidman at 2101-2103. The Senate was upheld in this action by the Conference Committee and subsequent passage of the conference bill. H. Rep. 2586, at 52-53, 77th Cong., 2d Sess. (1942), Seidman at 2101-2103.

2. _1950 to the Present_. Since 1950 there has been a dramatic growth in the number of qualified defined benefit pension plans. Throughout this period of plan growth no serious effort was made to restrict the right of employers to recover excess assets.

It can be justifiably concluded that a whole generation of corporate managers have exercised the business judgment that their companies should invest in the future retirement security of their employees on the condition and with the express understanding that excess assets could be recovered in the event of plan termination. This reliance interest must not be taken lightly. Under our laws parties who act in justifiable reliance on settled principles of law in the ordering of their private and commercial affairs are entitled to protection against legislation or regulations arbitrarily and retroactively defeating those reasonable expectations. Any change in existing laws regarding asset reversions is a serious undertaking and should preserve the basic principles of current law.

C. _Policy Implicit in the Current Rules_. It is frequently stated that there is no national policy on this subject or that subject. The retirement plan area is no exception. However, this rhetorical technique is often a shorthand form of saying that the speaker opposes existing policy or has not made the disciplined effort necessary to discover that existing policy.

There is a national policy regarding reversions. It is implicit in the rules now in effect. Any principled effort to establish new policy or apply existing policies to new situations should begin with a rediscovery of the existing rules and their policy implications.

The current rules permitting reversions have the following retirement policy implications:

(a) Permitting reversions encourages the establishment of defined benefit pension plans;

(b) Permitting reversions encourages sound funding; and

(c) Permitting reversions fairly distributes extra assets to the party bearing the risks of funding.

1. Plan Formation. It is no accident that there has been an increased incidence of reversion activity over the past two to three years. This increased termination activity corresponds with the time period during which we have heard serious proposals to undermine the ability of employers to recover reversions in the event of plan terminations.

Employers perceive many of these proposals as no more nor less than an asset grab. It should be no surprise that employers who have prudently funded their plans are beginning to feel quite beleaguered by these proposals. Employers are also sensitive to the irony that these proposals have come at a time when the case law has reinforced their right to recover reversions and the Financial Accounting Standards Board has taken steps to require that plan liabilities and excess funding be reflected on employers' balance sheets. Many companies justifiably view themselves as having bought and paid for excess assets as a result of acquisitions in which the purchase price was adjusted to reflect overfunding of plans assumed by such companies. In fact, in the recent AM International case the PBGC successfully argued that the net worth of AM International for Title IV employer liability purposes with respect to the termination of an underfunded plan should include the amount of the excess assets which would remain if another plan were to terminate. In Re: AM International, Inc., ____ F. Supp. ____, 5 EBC 2337, 2343 (N.E. Ill. 1984).

We are here to deliver a clear message. Any unjustifiable restriction on reversions will, without any doubt, result in fewer defined benefit plans. Employers will simply not commit themselves to a one-sided deal in which the rules are "heads we win and tails you lose."

2. Funding. Actuarial science is an imprecise science. It is unlikely that an employer's contributions when

combined with fund experience will actually hit the precise funding target. This is particularly the case when a plan terminates.

ERISA funding standards leave considerable latitude to a company to choose among several permissive funding methods. Actuaries have tended to err on the conservative side (that is, to require contributions on the high end rather than the low end within the range of reasonable actuarial calculations). They have done so with employer knowledge and acquiescence. Even the most confident actuary knows that 30 to 40 year projections of salary, employee turnover and investment rates are only best guess estimates. The present incentives towards generous funding are without doubt in the best interests of employees and retirees. Of course they are not the result of sheer altruism. Rest assured they are largely a function of a delicate balance in the present law between the rules regarding the tax exempt status of plan assets, the deductibility of contributions, minimum funding standards and the right to recover any reversion. To the extent that reversions are restricted, this delicate balance will be upset and the result will unquestionably be less generous funding to the detriment of plan participants.

Prior to termination, a plan's funding rates, methods and factors are conservatively established with a view to their long term reasonableness. For example, a long term funding interest assumption is typically several percentage points lower than current annuity purchase rates. However, when a plan terminates this long term focus telescopes into a current determination of the cost of purchasing plan benefits through fully paid up annuity contracts. This is the termination funding phenomenon which more than any other factor explains why plans with funding obligations prior to termination are converted into overfunded plans upon termination.

As long as there is flexibility in the actuarial rates and factors which may be used, employers cognizant of their fiduciary duties to shareholders not to waste corporate assets will only use prudent and conservative funding assumptions if any excess assets which result from such assumptions are recoverable in the event of a plan termination. Thus, existing rules encourage sound funding and diminish the risk to employees and the termination insurance system presented by the termination of underfunded plans.

3. Fair Distribution of Excess Assets. When an overfunded plan terminates, all participants, including those who are not yet vested, are immediately vested in all benefits accrued to the date of termination. Before any benefits may be distributed the plan administrator must make provisions to assure that all benefits are guaranteed by the purchase of annuity contracts or the actual distribution of those benefits.

If the plan provides for mandatory employee contributions any reversion must be shared with employees. Otherwise, if the plan so permits, the excess may be returned to the employer as taxable income.

Before the sponsoring employer may recover the excess assets it must assure the PBGC, the Internal Revenue Service and, where appropriate, the Department of Labor that neither ERISA nor the tax laws are being violated and that the plan authorizes such reversions. Under the guidelines issued in May of 1984, special standards apply to so-called "spin off" or "reestablishment" situations. These standards are designed to assure that employers do not benefit from reversions to the detriment of ongoing plans.

Advocates of a new policy do not usually state clearly their intention to deny employers the advantages of investment gains. Rather, they talk in terms of the right of employees or retirees to the benefit of such gains or the need to anticipate future cost of living benefit increases or increases due to future pay increases. However the position is stated, it is bad policy, it is unfair to plan sponsors and it is destructive of employees' and retirees' best interests.

While some companies may provide cost of living increases on an ad hoc basis, they do so when they see a need and desire to do so. They must either increase funding costs or use a surplus to pay for the increased benefits. In the event that an existing surplus is dedicated to such ad hoc increases, it is a voluntary decision and should remain so. No legislation should be adopted mandating such increases whether from surplus or any other source.

Similarly, future salary administration and plan design decisions should not be fettered by the concept that a plan design decision to base benefits on final pay is a permanent decision. Termination of a final pay plan should not trigger an obligation to anticipate and fund the benefits which would result from future pay increases. Employers should be free to exercise their reserved right to amend or terminate their plan at any date and fund only the benefits accrued at that time. Any other rule will at the very least bring to a rapid halt the practice of many employers of providing final average rather than career average benefits.

II. Is There A Basis For Development Of A Consensus View?

We encourage you to carefully study the terminations which have occurred to date to provide an accurate picture of the actual effects of such terminations. You should include information regarding new plans established thereafter. You may also wish to take note of the productive uses to which reversions have been applied. We believe you will find that many reversions have been used in ways which create jobs and contribute to economic growth.

There is a growing basis for hope that common ground can be found between the conflicting views on this issue. Despite the early overstatements of the objections to reversions as a theft of employee funds, there are signs that the views of the opposing factions in this debate are tempering and are beginning to converge. We encourage this process.

The formation of this task force is the best evidence that this process has moved beyond the stage of an overheated political, social and media debate to a more serious effort at compromise.

Make no mistake about the Chamber's dedication to preserving the rights of employers to recover reversions. However, we realize that not all situations are the same. As the administration's policy pronouncement in May 1984 illustrated, not all plan terminations fit neatly within the traditional legal framework permitting reversions. We encourage the development of creative proposals to permit reversions with full protection of participant rights but without burdensome procedural barriers or possibly without a plan termination. In addition, we may be favorably disposed towards creative solutions which permit employers to utilize excess plan funds to provide other unfunded or underfunded employee benefits such as retiree health and life benefits.

We stand ready to work with the members of this panel and with any other group of serious-minded proponents of policy improvement. We would like to work with the members of this panel in good faith to help diffuse the overheated rhetoric which has marked this debate over the past three years.

Senator METZENBAUM. Mr. Gulotta?

Mr. GULOTTA. Chairman Metzenbaum, Chairman Clay, members of the Senate Labor Subcommittee and members of the House Labor Management Subcommittee, I am Michael J. Gulotta, President of AT&T Actuarial Sciences Associates, and I am appearing here today in my capacity as a member of the National Association of Manufacturers Employee Benefits Committee.

Accompanying me today is Vicki Caldeira, NAM's Associate Director of Employee Benefits.

The NAM believes that the administration's proposal on funding and termination of defined benefit pension plans gives balanced consideration to employee benefit security and the need to provide responsible employers with incentives to continue in the defined benefit pension plan system. The proposed stricter funding standards will make more employers accountable for their pension promises. Such standards will also enhance employee benefit security, and this is a most critical priority.

We commend the administration for addressing the funding issue.

Of the 115,000 corporate premium payers who finance the PBGC, two-thirds maintain well-funded pension plans. This majority cannot be expected to continue to pay for 65 percent of the guaranteed benefits of those plan sponsors who terminate their underfunded pension plans.

It is our understanding that the administration also plans to introduce a bill proposing a variable rate premium. The NAM would strongly support such variable-rate premium legislation as it would further strengthen the defined benefit plan system.

The need for business to be more competitive is also recognized through the administration's proposal to allow withdrawals of excess assets from pension plans without requiring a plan termination.

Referring back to Mr. Clay's discussion with Mr. Brock this morning regarding pensions and deferred wages, I would like to point out that pension benefits are the deferred wages, not pension assets. To the extent there are assets in excess of the amounts needed to provide those benefits, those excess assets are not deferred wages and should be accessible by the employer.

The need for business to be more competitive is further recognized in the administration's proposal through the ability to transfer without current tax consequences a portion of excess pension plan assets to fund for current retirees' health coverage. The NAM strongly supports such concepts which allow for the optimal use of excess assets without affecting the defined benefit plan promise.

We commend the administration, too, for not requiring automatic cost-of-living increases or other restrictions on excess assets that would interfere with management and collective bargaining decisions. Such restrictions would seriously undermine the basic social policy goal of encouraging the defined benefit pension plan system.

The NAM does have some specific concerns which have not been adequately addressed in the administration's proposal due to the general nature of that proposal. We feel that the following clarifications or changes need to be made, and there are four general areas.

One, in the area of minimum benefit security, we think that that term needs to be more clearly-defined in legislation. No. 2, we have some problems, some serious problems, with the controlled group approach that is taken in the proposal. No. 3, we think that any additional restrictions with regard to employer securities in floor-offset arrangements would be unfair to financially strong companies. And finally, we think there need to be some reasonable transition rules with regard to the minimum funding standards.

We appreciate the opportunity to testify on the administration's proposal, and we hope we will be able to support the bill that eventually evolves. We will be happy to work with the administration and with you in the further development of legislation to that end.

Senator METZENBAUM. Very good, Mr. Gulotta. Thank you very much.

[The prepared statement of Mr. Gulotta follows:]

National Association of Manufacturers

TESTIMONY OF

MICHAEL GULOTTA
PRESIDENT AND CHIEF ACTUARY
AT&T COMPANY - ACTUARIAL SCIENCES ASSOCIATES, INC.

ON BEHALF OF THE

NATIONAL ASSOCIATION OF MANUFACTURERS

ON

THE ADMINISTRATION'S PROPOSAL ON THE
FUNDING AND TERMINATION OF
DEFINED BENEFIT PENSION PLANS

BEFORE THE SUBCOMMITTEE ON LABOR
UNITED STATES SENATE

AND

THE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
U.S. HOUSE OF REPRESENTATIVES

MARCH 24, 1987

1331 Pennsylvania Ave., NW • Suite 1500 - North Lobby • Washington, DC 20004-1703 • (202) 637-3000

Executive Summary

The Administration's proposal on the funding and termination of defined benefit pension plans has been developed in response to concerns regarding overfunded and underfunded single employer defined benefit pension plans. Since 1980, 16 billion dollars in termination/reversions have taken place. During this time, the Pension Benefit Guaranty Corporation (PBGC), the agency that insures these pensions, has experienced a rising deficit that currently amounts to four billion dollars. The PBGC has indicated that this deficit has grown as a result of only a few claims for very large amounts. More than 76,700 company plan sponsors have well funded pension plans. These companies, through premium payments to the PBGC, currently must subsidize more than 65% of the guaranteed benefits of plan sponsors who terminate underfunded pension plans.

The Administration's proposal would allow employers to withdraw excess assets without requiring a pension plan termination, and require a cushion of assets in the plan to protect employee benefit security. It would also allow employers to transfer, without current tax consequences, a portion of excess assets to fund for current retirees' health coverage. The minimum funding standards for single employer defined benefit pension plans would also be tightened. NAM supports the underlying concepts of this proposal as an important step toward encouraging optimal plan funding and strenghthening the single employer defined benefit pension plan insurance system.

Chairman Metzenbaum, Chairman Clay, Members of the Senate Labor Subcommittee, and Members of the House Labor-Management Subcommittee, I am Michael Gulotta, President and Chief Actuary of Actuarial Sciences Associates, Inc., appearing today in my capacity as a member of the National Association of Manufacturers' Employee Benefits Committee.

Accompanying me is Victoria Caldeira, NAM's Associate Director of Employee Benefits. The National Association of Manufacturers is a voluntary business association of over 13,000 companies of every size and industrial classification, located in every state. Our members employ 85% of the workers in manufacturing employment and produce over 80% of the nation's manufactured goods. NAM also has an affiliation with 158,000 businesses through its Associations Council and the National Industrial Council.

The NAM thanks you Chairman Metzenbaum, Chairman Clay and members of your respective subcommittees, for the opportunity to comment on the funding and termination of defined benefit pension plans as proposed by the Administration, February 19.

The Administration's Proposal

Generally, the proposal gives balanced consideration to employee benefit security and the need to provide responsible employers with incentives to continue in the defined benefit pension plan system. The proposed stricter funding standards will make more employers accountable for their pension promises. This is desirable, given the four billion dollar deficit of the Pension Guaranty Benefit Corporation (PBGC). Of the 115,000 corporate premium payers who finance the PBGC, two thirds maintain well funded pension plans. This majority cannot be expected to continue to pay for 65% of the guaranteed benefits of those plan sponsors who terminate their underfunded pension plans.* Companies with well-funded plans can no longer afford to absorb these added costs, as employers must now compete in a world marketplace. Nor can the federal government be expected to absorb the added costs; rising federal budget deficits have directly contributed to the cumulative U.S. trade deficit of $500 billion since 1982. The need to improve United States competitiveness in a global economy is NAM's number one priority for 1987.

We commend the Administration for addressing the funding issue through the introduction of a competitiveness package of which this proposal is a part. It is our understanding that the Administration also plans to introduce a bill proposing a variable rate premium, based upon the risk that a pension plan has of terminating in an underfunded position and transferring that unfunded liability to the PBGC. NAM would strongly support such risk-related premium legislation as it would further strengthen the defined benefit plan system by more fairly allocating the costs of the single employer pension plan insurance system.

*Data compiled by Pension Benefit Guaranty Corporation (PBGC).

NAM has long been an advocate of the defined benefit pension system as a major component of pension policy. Retirement income, as recognized by the NAM, should be based on a combination of Social Security, personal savings, and employer pension plan benefits. In this respect, NAM members have taken their commitments seriously with respect to funding their employees' pension benefits and assuring the continued existence of pensions upon employee retirement.

The need for business to be more competitive is also recognized through the Administration's proposal to allow withdrawals of excess assets from pension plans, without requiring a plan termination, and the ability to transfer, without current tax consequences, a portion of the excess pension plan assets to fund for current retirees' health coverage. NAM strongly supports such concepts, which allow for the optimal use of excess assets without affecting the defined benefit plan promise.

We commend the Administration, too, for not requiring automatic cost of living increases or other restrictions on excess assets that would interfere with management and collective bargaining decisions. Such restrictions would seriously undermine the basic social policy goal of encouraging the defined benefit pension plan system.

Defined benefit plans are a promise by the employer to provide a pension benefit, typically for the life of the employee-retiree and the spouse. The nature of the pension promise and obligation remains unchanged; the employer-promised benefit level is fixed. Often the level of benefits is set through collective bargaining. The benefit agreed to is known to the employee in advance and the employee has the ability to adjust his/her personal savings to complement Social Security and the retirement pension to assure economic security. In a defined benefit plan, the employer essentially bears all the funding and investment risk. The Internal Revenue Code permits employers to fund that pension promise through a trust. Pension plan assets accumulate in the trust for the purpose of providing promised benefits. To the extent such assets exceed the value of the promised benefits, these excess assets are rightfully the employer's. Any restrictions on the use of excess funds would be opposed by NAM.

Broad concern about retirees and the inadequacy of the promised benefit should be addressed, if required by Congress, in the context of social policy. This topic is not appropriate for consideration in the context of termination/reversions or pension funding policy. Revenue for such social policy should appropriately be from general revenues; corporations should not have to pay for what is perceived as inadequacies in the standard of living of our nation's elderly.

Recommendations for Improving the Administration's Legislation

The NAM does have some specific concerns which we feel have not been adequately addressed due to the general nature of this proposal. Our support of the Administration's proposal is contingent upon the following clarifications being made:

Minimum Benefit Security. We have interpreted "minimum benefit security level" to mean no more than what is required for a plan to be fully funded for current accrued and probable future contingent benefits. This needs to be clarified in legislation. In addition, the interest rates to be used in determining "termination liability" must also be specified.

Controlled Group Liability. The application of controlled group liability in the context of sales of businesses presents a major problem. Certain safe harbors must be provided to assure that employers are not unduly restricted in their day to day business transactions. The funding status of the plan should be a primary consideration in determining any such safe harbors. Language concerning controlled group liability is crucial to the NAM and hence to NAM endorsement. We would like to actively participate in the development of such language.

The process of evaluating plan asset sufficiency must also be simplified to deter adverse effects on business transactions. Employers should be permitted to use the most recent actuarial valuations already in existence. Without this ability, companies would have to undergo the lengthy and administratively complex process of determining valuations as of the date of the sale of a business. During this period many a potential buyer would be lost. This buyer would often represent the only viable option to a seller other than shutting down a division or a subsidiary.

The Department of Treasury recently suggested that companies involved in sales of subsidiaries would be required to treat excess assets as if a termination/reversion had taken place. Thus, companies would be forced to consider excess assets as income for tax purposes. This was not in the original Administration proposal. NAM opposes the inclusion of such a provision as it would artificially create income that does not exist under present law or generally accepted accounting principles.

Employer Securities in Floor-Offset Arrangements. Proposed restrictions on the use of employer securities in floor-offset arrangements must also be eliminated from the Administration's proposal. The security of participants in these types of arrangements is more than adequately protected by Section 1175 of the Tax Reform Act of 1986. This section requires ESOPs to offer partial diversification elections, for up to 25% of a participant's account balance, to employees meeting certain age and participation requirements. At least three investment options must be provided. The percentage of an employee's account balance that can be diversified increases to 50% for employees age 60 or above.

If risk of loss to the PBGC is the concern being addressed here, additional premium payments to the PBGC would be a more acceptable alternative than outright restraints on the use of these arrangements. Such restraints are unfair to financially strong companies and their employees who view ESOPs as an important pension benefit.

Reasonable Transition Rules. The NAM has one additional concern that is of the utmost importance to our membership. Reasonable transition rules must be developed concerning the new stricter funding standards. The proposed new amortization requirements represent a drastic departure from current law. Consequently, a significant period of transition, to help companies with underfunded plans to meet the new standards, should be added to this proposal.

The NAM appreciates the opportunity to testify on the Administration's pension proposal. We hope we will be able to support the bill that eventually evolves concerning the funding and termination of defined benefit plans as wholeheartedly as the concepts we endorse today. We will be happy to work with you in the further development of legislation to that end.

Senator **Metzenbaum**. Mr. Anderson, we are happy to hear from you.

Mr. **Anderson**. Mr. Chairman, my name is Vance J. Anderson. I am employee relations counsel at Mobil Oil Corp., and I appear today on behalf of the Association of Private Pension and Welfare Benefit Plans. I believe a copy of the formal testimony has already been entered into the record by the chairman, so I will summarize at this point.

Senator **Metzenbaum**. That is correct.

Mr. **Anderson**. Let me suggest that the Association, having reviewed the administration's narrative proposals at this stage, is unable to make precise or totally refined decisions with regard to the proposals, but based on what we think we understand at this stage, Mr. Chairman.

With regard to the funding proposals, I think we view with general agreement the proposal that certain funding for certain liabilities and experienced gains and losses should be undertaken. Accordingly, we will support or would expect to support that element of the Administration's proposals when it is reduced to legislative language.

We would also agree that we would support a minimum funding standard related to short-term cash flow requirements if it could be drafted in such a way to achieve the same sort of result that currently prevails or is imposed on multi-employer plans. We do not believe that the administration's proposal, if we understand it correctly, would achieve those same or related results. A problem in this regard is that their definition of "fully funded" disregards the actuarial experience, or at least we think it does, disregards the actuarial experience of the plan and therefore tends to or has the effect of overstating the true benefit liability for the plan itself.

With regard to the asset reversion proposals, we endorse the proposal to allow the free transferability of excess plan assets to fund retiree medical benefits. We believe at the same time that generally speaking, the scheme as proposed by the administration is overly complex, and as applied to control groups will, after analysis by the committee and by its staff, prove not to be a workable alternative to the present system.

I must caution you, Mr. Chairman, that we may disagree on some policy objectives here inasmuch as the Association continues to be committed to the principle that if excess assets remain in a plan after all liabilities to participants have been discharged, the ownership of those assets will be determined by reference to the contract or the agreement on which the original contributions were made to the plan.

With regard to the PBGC premium proposal, if we understand the proposal as it has been articulated to this date, we would suggest to you that our reaction at this stage is we are terribly distressed by the enormity of the premium increase being requested by the administration. A $500 million increase in the premium tax is enormous by any measure or any standard. We are mindful of the enormous unfunded liabilities which have been assumed by the PBGC in the last several years; in particular, we are mindful of the problems associated with steel industry-related terminations in 1986.

We are not prepared to endorse the administration's proposal for a premium increase at this time. We think that further study is necessary. We note that the immediate financial needs of PBGC are such that they can be met from the existing premium base and the existing assets of the corporation for a period of some years. We think that this time should be utilized to carefully consider alternatives to the proposal as put forward by the administration.

Do I have additional time, Mr. Chairman, or is that the warning?

Senator METZENBAUM. Until the red light comes on.

Mr. ANDERSON. Okay. Let me make a few additional comments of a general nature, if I may. The administration has focused on a definition of "fully funded". This is a radical departure from the old concept that we are now utilizing. All of our plans file an annual report of 5500. In that annual report, we display the liabilities of the plan in schedule B. You will notice in the attachment to the administration's proposal, they derive from the schedule B material as submitted by our plans a liability statement. The liabilities that they are proposing that we target on are substantially greater than the liabilities displayed in schedule B.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Mr. Anderson.

[The prepared statement of Mr. Anderson follows:]

TESTIMONY OF

THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

BEFORE

LABOR SUBCOMMITTEE
SENATE LABOR & HUMAN RESOURCES COMMITTEE

AND

LABOR-MANAGEMENT RELATIONS SUBCOMMITTEE
HOUSE EDUCATION & LABOR COMMITTEE

ON

"PROBLEMS RELATED TO TERMINATIONS OF OVERFUNDED AND UNDERFUNDED SINGLE-EMPLOYER PENSION PLANS"

TUESDAY, MARCH 24, 1987
WASHINGTON, D.C.

VANCE J. ANDERSON
[Witness]
Employee Relations Counsel, Mobil Oil Corporation
Member, APPWP Board of Directors

Association of Private Pension and Welfare Plans
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Mr. Chairman, Members of the Committees, I am Vance Anderson of the Mobil Oil Company. I am here today representing the Association of Private Pension and Welfare Plans ("APPWP"), on whose Board of Directors I serve. The APPWP is a non-profit organization founded in 1967 with the primary goal of protecting and fostering the growth of this country's private benefit system. The APPWP's over 400 members represent hundreds of plan sponsors as well as the leading support organizations to benefit plans: investment firms, banks, insurance companies, accounting firms, and actuarial firms.

We are pleased to have the opportunity to share our views on the proposals in the President's Competitiveness Initiative that affect funding and termination of defined benefit plans. We recognize that the proposal is in its early stages and, accordingly, many of our initial reservations may be answered by detail not yet disclosed or transition rules not yet formulated. We welcome the chance to work with the Congress and the Administration to achieve a workable solution to the issues addressed in the proposal.

At the risk of repeating ourselves, defined benefit plans are the most secure and reliable retirement vehicles of the many kinds of plans that exist today; however, they are not endlessly elastic. In the last dozen years, they have been battered relentlessly with legislative and regulatory change -- to cure budget ills, to address perceived over-pensioning, to deal with the abuses inherent in the ERISA Title IV insurance program. Thus, it is important to make very sure that the legislative proposals are critically needed and not just a continuation of the tinkering which has gone on for the last decade. The defined benefit system cannot afford change for its own sake.

There is no reason to believe that the 1984 Administration reversion guidelines and other recent changes in the law, such as the strengthening of the anti-cutback rules, are ineffectual in protecting employees. While the guidelines are not perfect and create some economic inefficiencies in "phantom terminations", we do not believe that they should be hastily discarded. The original Advisory Council recommendations directly addressed the shortcomings in the reversion guidelines; the proposals before us today seem to have lost sight of the broad goals.

Over-regulation and undue restrictions on defined benefit plans will not inure to anyone's benefit. To the extent that employers decide that defined benefit plans are not worth their cost and burden, all employees will suffer, as they become the risk takers with respect to their retirement security. We believe that this issue should be addressed with full recognition of the dangers of radically departing from the current legal framework which has encouraged the growth of defined benefit plans.

Underfunded Plans

While we may disagree with some of the details in the proposal's minimum funding rules, their premise is consistent with the legislative changes to Title IV in the last session, and would further the goal of limiting PBGC's exposure to future large losses. We recognize that for some severely underfunded plans, further tightening of the standards may be necessary. Moreover, consideration of the PBGC's premium proposals in connection with the minimum funding standards is critical. Discussion of any proposed premium increase should be accompanied by the full disclosure of the PBGC's current financial status and its assumptions for its future needs. After adequate public debate on whether -- and the extent to which -- a premium increase is needed, we would be eager to work with Congress to see if a variable rate premium is a reasonable approach. We are uncomfortable with a premium increase on a flat rate basis; however, the variable rate basis could pose hazards for new plans, for legitimate benefit increases, for the continued maintenance of those defined benefit plans which are not now well-funded. There is another issue to grapple with as well. In the last several years, a handful of employers have shifted enormous liabilities to the PBGC and then left the defined benefit system. If the entire burden of these losses is shouldered by current sponsors of defined benefit plans, these employers will be disproportionately responsible for a problem which might more reasonably be borne by society as a whole. In sum, we look forward to working with you on these issues, for it is incumbent on us to support changes which will stem the losses that the Title IV program has suffered, often from plans fully in compliance with the minimum funding standards.

Some of the proposals, such as shortened amortization periods, with appropriate transition rules, may both encourage and achieve better funding for badly underfunded plans. However, we find that these rules are insufficiently targeted -- in our view, it is far too stringent to consider a plan to be underfunded until it has 110% of the assets it would need to cover all benefits, including those, like early retirement subsidies which are contingent on events which have not yet, and may never, occur. The proposal needs to fasten on a more realistic definition of fully funded. In addition, we need to worry about the effect shortened amortization periods will have on new plans and on the granting of benefit increases. We assume that the purpose of the proposal is to strengthen defined benefit plans, and not to make them so onerous to maintain that there will be no new sponsors of such plans in the future. Thus, the rules must be drafted so that employers will not be discouraged from establishing new plans. Moreover, without adequate transition rules, industries which are already on the brink of financial insolvency will be dealt the final blow with sudden, far stricter funding standards.

We need to keep in mind the additional administrative costs of the new rules and weigh the advantages, if any, of requiring additional calculations -- such as determining plan liabilities as if all contingent liabilities will become accrued benefits regardless of the likelihood of such an event -- against the added costs of calculating liabilities several times for different purposes -- shareholders reporting, funding, FASB, internal corporate reporting, etc. We need to remember that defined benefit plans on an ongoing basis were never intended to be fully funded at all times. We should not rush headlong into so over-tightening the standards that defined benefit plans are abandoned in favor of "fully funded" defined contribution plans. So, for example, we are very concerned about the new cash flow minimum contribution rule. Because it is keyed off the 110% of all liabilities definition, it would require minimum contributions even where the plan is still overfunded on a termination basis. While we recognize that excessive lump sum payments or annuity purchases can strip assets from a plan, the cash flow rule as drafted here is overkill. An overriding minimum contribution, narrowly focussed as in the Multiemployer Act, is a much more rational approach.

All of these proposals deserve further discussion, although, ultimately, not all of them may be necessary to strengthen underfunded plans. Only a handful of plans are seriously underfunded; yet these rules create uncertainty, higher contribution requirements, earlier due dates and ongoing controlled group responsibility for all plans.

Overfunded Plans

We are particularly concerned with that part of the proposal that deals with overfunded plans. As we have testified in the past, we believe that overfunded plans do not pose a risk to the defined benefit system, nor present a problem which Congress needs to address. The Administration proposal suggests that plan terminations are costly and expensive, that they reduce participants' benefit security with respect to future benefit accruals, and that they discourage the employer from granting ad hoc benefit increases or cost of living allowances to retirees. We disagree. While plan terminations may be costly, under current law, they provide full benefit security to participants and all of the excess assets to the employer. Some employers may prefer a direct withdrawal approach; few, if any, however, would support the elaborate cathedral that is before you today. Many would like to take advantage of the opportunity to transfer excess pension funding to tax favored retiree health arrangements; few would meet the proposal's requirements for doing so. We were pleased that the proposals would allow excess assets to be transferred to fund retiree health benefits, because we see this as a very appropriate step in the direction of securing retiree health benefits. For the reasons set forth below in more detail, however, the opportunity to make such a transfer under this proposal is too restricted. We also question the need to repeal Code section 401(h), especially since no justification for its repeal has been put forth.

The proposal imposes complex requirements, revised actuarial calculations, frequency limitations on the amount of excess assets that can be withdrawn, even where an employer only maintains overfunded plans. For example, under the proposal, an employer who decides to replace a defined benefit plan with a defined contribution plan, and who fully vests and annuitizes all participants, as the Code and ERISA currently require, would not be permitted to receive all the excess assets that remain after annuitization, so long as that employer maintains any other defined benefit plan, regardless of how well-funded the remaining defined benefit plans may be. The remaining excess assets would have to be distributed among the employer's other overfunded plans. We fail to see any reason for such a result.

Large controlled groups would find the proposal nearly impossible to live with. Some large controlled groups maintain hundreds of defined benefit plans, some of which are collectively bargained, some of which are not, some well-funded, some not. The rules are very complex with respect to these groups, and appear to sanction, and indeed under some circumstances, require, wholesale transfers of assets among plans in a controlled group, in a way that seems quite inconsistent with the exclusive benefit rules of current law. Such transfers might well violate other laws as well, such as overfunding in plans maintained by government contractors, where the government has or could assert a legitimate claim to the excess. Moreover, mergers and acquisitions would be made far more complicated, and would need to take into account phantom excess funding or underfunding in order to price a transaction. Despite the vague promise of "special frequency rules" for sales and purchases of divisions or subsidiaries, an employer would need to carefully time a transaction to coincide with either other business transfers or planned withdrawals in order to ensure that these "limits" are not inadvertently exceeded. In many ways, the proposal is a catch-22 in this area: if an employer initially takes the full permissible withdrawal in year 1 of a 10-year period, and in year 9, sells a division with an overfunded plan, it cannot receive the overfunding because of the "frequency limit" but is taxed on the overfunding transferred, as if it had removed the excess before the transfer.

Many more examples could be given to illustrate our concern that this proposal is ambitious far beyond the scope of any conceivable abuse. Rather than take the time here, we would urge that business groups and labor groups sit down with the relevant government officials and fully explore reasonable rules, with appropriately focussed goals. We urge you to approach this proposal armed not only with a clear understanding of the importance of defined benefit plans to American workers, but also of the burdens already placed on employers who have chosen to maintain these plans. The strength of our pension system is that it is voluntary; no particular type of plan or level of benefits is mandated, and indeed no employer is required to establish or continue to maintain a retirement plan at all. In large part, the investment strategy of defined contribution plans is short term, in recognition of the fact that it is the participant who takes the risk. In contrast defined benefit plans are the single largest accumulation of funds for long term capital formation. These are plans which can afford the investment in American industry's future over the long haul; to the extent these plans are discouraged, their investment support is eliminated as well.

The trend toward defined contribution plans has escalated significantly in the last 10 years and shows no sign of slowing. Indeed, 1984 was the first year in which the number of defined benefit plan participants covered under the Title IV insurance system declined. Defined contribution plans, as a means of controlling corporate benefit costs, are very attractive. Because contributions are generally based on a percentage of payroll, annual costs are always known. Administrative costs are also much lower than in defined benefit plans, since complicated actuarial valuations are not necessary and complex annuity rules may be avoided. The defined contribution plan may also alleviate protracted recordkeeping -- once an employee is cashed out, there is no obligation to track this employee in the future. The Administration's proposal makes the cost, predictability and administrative burden of defined benefit plans even greater, further skewing the incentives toward defined contribution plans. If enacted in the form in which it has been proposed, you may see large-scale defections from the system. In our view, that result would be tragic. We would hope that by working with staff, rather than their working in a vacuum, we could avoid it.

Oral Comments of Vance J. Anderson
On Behalf of
The Association of Private Pension & Welfare Plans (APPWP)
Before the Sub-Committee of Senate Labor
and Human Resources and House
Education & Labor Senate Committee
on March 24, 1987

I. The Administration's Funding Proposals

Based on our experience to date, we support, in concept, the proposition that accelerating the funding for certain liabilities and experience gains and losses is a good idea.

(a) Accordingly, we view with favor the reduction in amortization periods for unfunded liabilities and experience gains and losses as proposed by the Administration.

(b) We would also support a minimum funding standard related to short term cash flow requirements, were it to be properly structured to achieve results similar to the comparable requirements levied on multi-employer plans. The Administration's proposal in this regard is defective as it proposes a definition of "fully funded" which disregards actuarial experience and, accordingly, will overstate the true benefit liability for most pension plans.

II. The Administration's Asset Reversion Proposal

(a) We believe the scheme proposed by the Administration is overly complex and as applied to "control groups" will, on analysis, not prove to be workable.

(b) We remain committed to the principle that if excess assets remain in a Plan after all liabilities to participants have been discharged, the ownership of those assets should be determined by reference to the contract or agreement on which the original contributions by the employer were based.

III. PBGC Premium Proposal

(a) We are distressed by the enormity of the premium increase being requested by the Administration. A $500 million increase is by any measure an extraordinary burden. We are mindful of the enormous unfunded liabilities which have been assumed by the PBGC in the last several years, in particular, the staggering burden of steel industry related plan terminations in 1986. We are not prepared to endorse the Administration's proposal until a thorough going appraisal of PBGC's operations and financing methodologies has been undertaken. We note that the immediate financial needs of PBGC may be met in a period of years without any increas in premiums and urge that this time be utilized to consider alternate financing mechanisms.

(b) It has become all too easy to look to what are erroneously assumed to be the deep pockets of the premium payer to solve PBGC's problems. We think that careful analysis of the experience which gives rise to PBGC's request for a premium increase should be undertaken. To the extent that this experience is determined to be isolated to certain industries or to involve unique or unusual, plan design or financing mechanisms, it would be appropriate to consider carving out those situations and dealing with them in some separate fashion.

IV. General Comments

The Administration's New Definition of "Fully Funded"

(a) While we recognize the unique problem presented by those few plans which offer "shutdown" benefits, we do not agree that it is appropriate to require or expect that pension plans be funded for full utilization of standard plan provisions. It is reasonable and appropriate to expect that plans will be funded for experience based utilization. If we fund for 100% utilization when we know our experience will be less, we will be overfunded for the true benefit obligations of the plan. We cannot see where this serves the interest of either the Federal Government, the plan sponsor or the participant.

(b) Control group test

While there is some superficial appeal to a requirement that control groups of corporations be responsible for funding the plans offered within the group, our experience with similar legislative proposals in the recent past leads us to suggest that it will be most most difficult to formulate a standard proposal in this area that does not have serious negative consequences.

(c) We would urge careful consideration of these proposals before any action is taken by Congress. We believe that there is time to explore the specific proposals which will be made by the Administration as well as any alternatives which may be presented. We do not believe that the financial situation of the PBGC or the condition of defined benefit pension plans generally, requires hasty action on your part.

Senator METZENBAUM. Mr. Stone?

Mr. STONE. Thank you, Mr. Chairman.

My name is Bob Stone. I appear here today as chairman of The ERISA Industry Committee. I am also an attorney with IBM Corp., but I am representing today ERIC's membership of more than 100 of the Nation's largest employers who are concerned with national retirement and benefit issues.

I am joined by John Vine, of Covington and Burling, Counsel to the ERISA Industry Committee.

First let me just comment on two points before getting to the proposal itself.

We recognize that there is a major concern with the PBGC's ability to cover the potential unfunded liability which appears to have been caused to a large extent—reportedly, up to 80 percent—by several underfunded plans in the steel industry. While ERIC does not propose to support any proposal to resolve that at the moment, we must recognize that title IV of ERISA as enacted in 1974 was never intended to provide coverage for the type of liability which is likely to be dumped on the PBGC and on the plan sponsors whose premiums support the PBGC.

We think that Congress should study a more equitable resolution of the problem, to spread the costs across the spectrum broader than just the universe of defined benefit plans. If that were done, then both the PBGC and the plan sponsor community would have time to work with these committees to develop better long-term solutions.

Secondly, we are concerned that some officials are reported to have said that the administration's proposal is on a fast track. We think that with this proposal not even having been reduced to legislative language yet, without the ability to evaluate it properly, to even consider a fast track is terribly premature. The fast track which Congress followed in COBRA continuation coverage and tax reform welfare benefit nondiscrimination rules did not give Congress time to consider how the requirements would be administered, how participants would be affected, or the unintended consequences.

Both of those laws now require substantial revision and are the subject of major technical amendments.

With those two concerns noted, let me quickly pass on to the administration's proposal.

ERIC believes that pension plan commitments must be funded in an adequate and timely fashion to assure the security of the retirement income for plan participants. The administration's proposal recommends strengthening the minimum funding standards. We could not agree more. However, the proposal in its concept paper opts for an excessively complex set of standards which would appear to apply even to pension plans which under any current definition would be deemed well-funded. We believe simpler approaches are available and should be studied and pursued.

This course would be particularly crucial in strengthening minimum funding standards and preventing a recurrence of some of the significant problems that have arisen because additional benefits were promised at a time when plans were underfunded. Such commitments, usually extracted in the course of difficult bargaining negotiations, should be subject to rules which place promises and funding in closer tandem.

While noting the political difficulties involved, we believe that if Congress is serious about fixing the problem, this potential for abuse must be addressed.

Thank you.

[The prepared satement of Mr. Stone follows:]

ERIC

The
ERISA
Industry
Committee

STATEMENT OF
THE ERISA INDUSTRY COMMITTEE
TO THE SUBCOMMITTEE ON LABOR
OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES
U.S. SENATE
AND
THE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
OF THE COMMITTEE ON EDUCATION AND LABOR
U.S. HOUSE OF REPRESENTATIVES

JOINT OVERSIGHT HEARING ON THE
TERMINATION OF SINGLE EMPLOYER PENSION PLANS

March 24, 1987

My name is Robert S. Stone. I appear today as Chairman of The ERISA Industry Committee, commonly known as ERIC. I also serve as Senior Corporate Counsel to International Business Machines Corporation.

ERIC is an association of more than 100 of the Nation's largest employers concerned with national retirement and benefit issues. As the sponsors of pension and savings plans covering some ten million participants and beneficiaries, ERIC's members share with both subcommittees a deep interest in the success and expansion of the private pension system.

Over the years, ERIC has devoted thousands of hours and committed a substantial portion of its resources to improving the single employer pension plan termination program. Others, including labor and other business groups as well as the members and staffs of the subcommittees and the Administration, also have committed substantial time and energy to this endeavor. Only last year, as a result of these efforts, Congress enacted the Single-Employer Pension Plan Amendments Act of 1986 ("SEPPA"), which was designed to strengthen the single employer termination program.

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ERIC also has a long-standing and serious commitment to the sound funding of private pension plans. This commitment is based on ERIC's recognition of the vital role that the private pension system plays in providing retirement security for our Nation's workers and on the realization that private pension plans will not be able to fulfill that role unless they are funded sufficiently to deliver the benefits they promise.

INTRODUCTION

Over the past several years, we have testified on plan funding and benefit security. For the record, we reiterate several observations we have made in the past.

First, sound pension funding requires an employer to fund pension benefits for its employees many years in advance of the time that the employees actually retire. If an employer could not fund its employees' pensions in advance, the security of its employees' pensions would depend on the employer's financial condition after the employees retire. Adequate advance funding for pensions was a primary goal of ERISA.

Second, the termination of an underfunded pension plan can have serious adverse consequences for the employees and beneficiaries covered by the plan; for the employer that sponsors the plan; for the Pension Benefit Guaranty Corporation ("PBGC"), which insures benefits under terminated plans; and for the other plan sponsors that pay premiums to the PBGC.

Third, although the PBGC insures certain benefits under terminated plans, not all plan benefits are covered by PBGC insurance. Thus, a plan termination can cause employees and beneficiaries to lose a portion of the benefits that the plan had undertaken to provide. To the extent that PBGC insurance applies, the PBGC must cover the cost of unfunded benefits by attempting to collect employer liability payments from the employer that sponsored the plan and by collecting mandatory annual premium payments from the employers that sponsor plans that have not terminated. Thus, ERIC's members, as the sponsors of on-going pension plans, have a strong interest in the sound funding of both their own plans and the plans of other employers.

Fourth, the private pension system is a voluntary system. Thus, any funding standards that make unreasonable financial demands on plan sponsors will discourage the formation and expansion of pension plans in the future. Excessively rigid funding standards also could cause the termination of many existing plans. As a result, minimum funding standards must strike a proper balance between the need for pension plans to be soundly funded, on the one hand, and the need to preserve and expand the voluntary private pension system, on the other.

Fifth, any unwarranted increase in termination insurance premium levels, any unnecessary restrictions on a plan sponsor's ability to dispose of segments of its business, and any rules that make it more difficult for an employer to terminate a plan that has met all of its benefit commitments will damage the private pension system by making it unduly burdensome for employers to adopt and maintain voluntary pension plans, thereby making it unlikely that they will do so.

It is in this context that we offer the following observations on the Administration's recent "Proposal on the Funding and Termination of Defined Benefit Pension Plans" (the "Proposal"). We also will comment on the variable rate premium or "VRP" proposal that the PBGC has indicated it will be releasing shortly. Our comment on the VRP proposal is limited, however, by the fact that we have only the sketchiest outline of the PBGC's intentions.

ADMINISTRATION'S MINIMUM FUNDING PROPOSAL

The Administration's Proposal recommends a number of measures that are designed to strengthen ERISA's minimum funding standards. ERIC strongly supports the Administration's emphasis on funding as a primary means of strengthening the benefit security of plan participants and of reducing the potential liability of the PBGC.

In recent years, it has become apparent that the existing funding standards do not always provide adequate assurance that a plan will be sufficiently funded. For example, a number of plans that have met the minimum funding standards have nevertheless terminated in a substantially underfunded condition. The burden of the underfunding has been borne both by plan participants and by the sponsors of other defined benefit plans, who have been required to bear substantially escalating payments to the PBGC in order to shore up its financial condition.

While ERIC agrees that strengthening the minimum funding standards is in order, ERIC cannot support the specific measures proposed by the Administration. Instead of proposing revisions in the existing funding standards, the Administration recommends that Congress engraft upon those standards several layers of additional standards, including --

(1) special minimum funding rules for a plan with a "Funded Ratio" of under 100%;

(2) complex amortization rules that would be based on the plan's Funded Ratio and the maturity of its liabilities;

(3) a Funded Ratio maintenance rule; and

(4) a cash flow rule.

Although the Administration's Proposal requires considerable amplification before it can be fully understood, it is apparent, even from the general terms of the Proposal, that the measures proposed by the Administration are unnecessarily complex. During the past three years, plan sponsors have been subjected to a barrage of new regulations under the Deficit Reduction Act, the Retirement Equity Act, the Single-Employer Pension Plan Amendments Act, the Tax Reform Act, and the Omnibus Budget Reconciliation Act. The last thing we need is yet another series of complex rules.

We believe that Congress should fashion a more simple and direct approach. For example, Congress might consider simply adjusting the 30-year amortization period permitted by current law. In addition, ERIC is examining other specific approaches.

Congress also should focus on striking a better balance between the required amortization periods (for funding and deduction purposes) and the five-year phase-in of benefits guaranteed by the PBGC. It is not appropriate to phase in the PBGC's guarantee over a five-year period, while requiring 30-year amortization of past service liabilities and imposing tax penalties on an employer that amortizes its past service cost over less than ten years. This issue can be addressed by shortening the minimum amortization periods under the funding standards and tax deduction rules, by lengthening the PBGC phase-in period, or by a combination of these approaches.

ERIC also believes that Congress should not allow the tax deduction limits to stand in the way of sound plan funding. The Administration's Proposal would allow an employer to deduct a contribution to the extent that it did not either cause the plan's assets to exceed the plan's termination liability or cause the assets in all plans of the controlled group to exceed the total termination liability of the controlled group's plans. ERIC believes this would be a step in the right direction.

Because their sales and net income are subject to the fluctuations of the business cycle, plan sponsors often are able to contribute substantially more to their pension plans in strong financial years than in "lean" years. In the past, the tax deduction limits have prevented employers from contributing more in the years when their financial performance would have supported substantially higher contributions to make up for those lean years. In effect, the existing tax deduction limits have prevented employers from adding to the benefit security of their employees when the employers have been most able to provide that added protection.

The Administration's Proposal, however, still would not permit the employer to anticipate future increases in the plan's liability. It also provides no deduction to an employer who makes a contribution to an underfunded plan when other plans in the controlled group currently have assets in excess of their total termination liability. We oppose both of these limitations.

ERIC agrees in general with the Administration's proposed additional limitations on the availability of minimum funding waivers. It is appropriate to clearly limit the use of funding waivers to temporary hardship circumstances. However, it is an inappropriate intrusion on the reality of business circumstances, and potentially harmful to the viability of a particular business or plan, to determine hardship on the basis of a controlled group. ERIC strongly opposes this portion of the Administration's Proposal.

ERIC also has reservations about the Administration's recommendation that an employer's minimum funding contributions be made on a quarterly basis, rather than when the employer's tax return is due, as is now the case. This proposal would interfere with the cash flow needs and normal business operations of many employers. We recommend that

Congress focus on what is really important here: the basic funding standards.

PBGC LIABILITIES

Strengthening the funding standards should go a long way to improving the financial condition of the PBGC. More rigorous funding requirements will cause plans to be better funded, which will, in turn, reduce potential PBGC liabilities.

However, the Administration's Proposal does not recommend any measures that would address the PBGC's existing liabilities -- liabilities created by terminations that have already occurred. In assessing whether it is necessary to increase the PBGC premium rate to fund the PBGC's existing liabilities, it is important to recognize that reportedly 80% of those liabilities are directly attributable to the financial difficulties of several large companies in the steel industry.

Many have questioned whether the termination insurance program should be expected to resolve a financial crisis for which the insurance program was not designed: the bankruptcy of a major portion of a basic U.S. industry. For example, if the liabilities of several bankrupt companies within the steel industry were removed from the PBGC's books, the current $8.50 premium level would be more than sufficient to amortize the PBGC's remaining liabilities. While ERIC has no position on what measures Congress should adopt to address the problems of the steel industry, we think it is important to point out the extent to which the PBGC's present financial condition is attributable to problems within that industry.

The PBGC has made numerous public statements that it will shortly be issuing a VRP proposal designed both to raise additional revenue for the PBGC and to require the sponsors of underfunded plans to pay substantially higher premiums than the sponsors of strongly funded plans. Since neither the Administration nor the PBGC has yet made a specific VRP proposal, it is not possible to comment on the VRP in any detail.

However, from a conceptual standpoint, while some ERIC members believe that a VRP would be desirable, others find that the current VRP proposals would be undesirable. Although their specific views will depend on what the PBGC ultimately proposes, two important factors shaping their views will be the magnitude of the premium increase -- both for those who have well-funded plans and for those who do not -- and the extent to which any VRP is phased in.

If, for example, Congress decides to defray the pension liabilities created by several bankrupt companies in the steel industry through a mechanism other than increased premium payments, the PBGC's unfunded liability will be substantially reduced, and the differential between the highest and lowest rates under a VRP structure also would be reduced. In addition, if a VRP is phased in over a period that gives plan sponsors sufficient time to implement fully any new funding standards that Congress might adopt, the ultimate impact of a VRP might be significantly reduced: the sponsors of plans that today are not strongly funded will be able to increase their plan contributions and thereby strengthen their plans' funding before any VRP would become fully or even partially applicable.

In any event, and without regard to any VRP proposal that the PBGC might offer, ERIC believes strongly that Congress should not alter the current law under which only Congress may change the payments made by employers to the PBGC. Those payments represent a substantial cost to plan sponsors. Any increase in those payments, which more resemble a tax than they do "premiums," will discourage the maintenance and expansion of private pension plans. Only Congress is in a position to determine periodically whether a change in employer payments to the PBGC is warranted. In no event should the PBGC be allowed to change the payments unilaterally.

In addition, if Congress concludes that it is necessary to enact legislation to improve the PBGC's financial condition, Congress should consider a wide range of approaches, and should not limit the range of options to more rigorous funding standards and a VRP. For example, we believe that Congress should consider limiting the circumstances under which a plan may qualify for a distress termination. To illustrate, Congress might require that only an employer that liquidates its business under chapter 7 of the Bankruptcy Code will qualify for a distress termination and that reorganization under chapter 11 of the Bankruptcy Code would not suffice. Congress might also consider whether it is possible to improve the PBGC's status as a creditor in the event of bankruptcy. Although ERIC takes no position on whether this would be an appropriate measure, ERIC believes that Congress should investigate this option.

Among the other measures that Congress should consider are an extension of the phase-in period for the PBGC's guarantee, a reduction or elimination of the PBGC guarantee with respect to certain ancillary types of benefits (for example, enhanced early retirement supplements), a requirement that the PBGC maximize its investment return (so that the PBGC will not continue to invest such a high percentage of its funds in fixed-income assets), and measures that would reduce the PBGC's overhead expenses.

THE PROPOSED CONTROLLED GROUP RULE

ERIC opposes the provisions in the Administration's Proposal that would cause any transfer of a plan outside of the employer's controlled group to be treated as a plan termination. This rule would seriously interfere with the purchase and sale of companies in the normal course of business. In addition, the proposed requirement that surplus assets be transferred from well-funded plans to less well-funded plans in connection with such plan terminations ignores the fact that most major employers are in a variety of lines of business, each of which operates as a separate profit center. It would be highly inappropriate to require the pension plan in one line of business to subsidize the pension liabilities incurred by another line of business. This is particularly true where one line of business is a defense contractor, and the federal government has, on a cost-reimbursement basis, financed the contributions that have enabled the defense contractor to maintain a well-funded plan. Similar issues would arise if one line of business were a utility or other regulated industry.

To the extent that the Administration is concerned about a plan sponsor that might attempt to terminate an underfunded plan, while continuing to maintain one or more ongoing pension plans with excess assets, we believe that a more limited remedy would suffice. For example, as we mentioned earlier in this testimony, Congress might wish to re-examine the requirements for a distress termination in a bankruptcy situation.

The Administration seems to be concerned that an employer would attempt to evade its funding obligations by selling a business with an underfunded plan to a buyer that is not financially capable of maintaining the plan. We would point out that only last year Congress addressed and resolved this issue. SEPPA added Section 4069 to ERISA to deal with transactions that are designed to evade liability under the termination insurance program. Congress should not second-guess a judgment it made only a year ago. Before any additional legislation is enacted, Congress should give this provision a chance to work. We believe that experience and analysis will establish that Section 4069 adequately addresses the problems raised by plan transfers.

PLAN ASSET WITHDRAWALS AND TRANSFERS OF ASSETS TO RETIREE HEALTH PLANS

ERIC applauds the recognition in the Administration's Proposal that an employer should be able to withdraw excess assets from a plan without terminating the plan. However, we are unable to support legislation that would make it more difficult for a plan sponsor to have access to such assets than it is under current law. The concepts in the Proposal that would permit plan sponsors to withdraw excess assets and transfer the assets to retiree health plans are strongly supported by our membership. The Proposal's methodology for accomplishing the withdrawals and transfers, however, appears to be so restrictive that few, if any, of ERIC's members would be better off under the Proposal than they are under current law. The controlled group and termination liability concepts set forth in the Proposal are like the proverbial "Catch 22" in that they seem to deprive employers of the ability to do that which the Proposal suggests is its objective.

In addition, ERIC has reservations about the proposal to limit such transfers to health benefit funds for current retirees. There is no compelling justification for limiting the welfare benefit fund proposal to current retirees. If an employer plans to provide post-employment benefits to active employees when they retire, it should be permissible to transfer excess pension assets to fund these future benefits.

Although ERIC supports the concept of a tax-free transfer of excess pension assets to a welfare benefit fund, it will not support this approach if it is accompanied by an unreasonable price tag. If a tax-free transfer provision can be adopted only if objectionable measures proposed by the Administration are also enacted, many employers will strongly oppose the entire package.

Moreover, ERIC strongly opposes the Administration's proposal to eliminate section 401(h), which provides the only tax-favored mechanism for pre-funding retiree health benefits.

The Administration's transfer proposal does not permit prefunding of these benefits. Members of Congress, other policymakers, and workers are becoming increasingly concerned about the growing problem of post-employment health care. It would be wrong to eliminate the only mechanism now available to secure some measure of health coverage for workers who look forward to retirement.

EXPANSION OF TERMINATION LIABILITY DEFINITION

ERIC strongly opposes the broad definition of "termination liability" contained in the Administration's Proposal. Under that definition, a plan's "termination liability" would include all of a plan's fixed and contingent accrued benefits, including even benefits that have not vested and benefits for which an employee has not qualified at the time of plan termination.

The Administration is asking Congress to revisit an issue that Congress addressed and resolved last year. In SEPPA, Congress determined that a plan would satisfy all of its obligations if it had assets sufficient to meet its benefit commitments at the time of termination. A plan's benefit commitments include all guaranteed benefits, all other vested benefits that would be guaranteed if it were not for specific limitations imposed by ERISA, and all early retirement supplements or subsidies or plant closing benefits that the participant has qualified for prior to plan termination. We believe that any expansion of this definition would unjustifiably expand the plan's pension obligations.

The Administration's definition of "termination liability" would go far beyond what is necessary to protect the PBGC and far beyond what a may plan promise to its participants. For example, if a plan offered special plant closing benefits, the Administration's Proposal appears to prevent the sponsoring employer from terminating the plan in a standard termination unless the plan has assets sufficient to provide the plant closing benefits in the event that a plant closing occurs in the future -- after the plan termination.

The Proposal thus would expand the scope of the plan's commitment to events that occur after the plan terminates. This would extend the employer's pension promise beyond the provisions of the plan, beyond what labor and management have agreed to in a bargained plan, and beyond the termination of the plan. Such an interference with the design of private pension plans is inappropriate and inconsistent with the decision that Congress made just last year when it limited a plan's obligation to its benefit commitments.

It bears emphasis that the private pension system is a voluntary system. Employers are not required to maintain a pension plan. If Congress now enacts legislation that makes it difficult or impossible for an employer to terminate a plan -- if adopting a plan becomes an open-ended commitment that an employer cannot terminate -- employers will be strongly discouraged from adopting pension plans and from adding additional benefits to their existing plans. Since the Administration's "termination liability" concept would have precisely this effect, we believe that the Administration's concept of "termination liability" would severely damage the private pension system as we know it today. We oppose this concept.

We very much appreciate the opportunity to present our views to these subcommittees. As in the past, we will be pleased to continue to work constructively with the subcommittees and their staffs on these issues.

Thank you for your consideration of our views.

Senator METZENBAUM. Thank you very much, gentlemen.

I do not intend to violate my own rules with respect to limiting questions, because of the hour. But I wanted to ask Mr. Anderson and Mr. Stone just to comment, if they will, and the others are welcome to comment as well, as to your views with reference to the propriety, the ethics, the moral and legal aspects of managers of pension funds being advised by the corporate leadership of those companies as to how they are to vote the stock of the companies in which they have an interest with reference to anti-takeover measures that may be pending in the corporate charter or the corporate bylaws or the resolutions of that corporation.

Mr. ANDERSON. I assume, Mr. Chairman, you have reference to the situation that was discussed in Pension and Investment Age, perhaps involving Rockwell. There was an article in Pension and Investment Age, involving Rockwell and GTE, perhaps—have I got the right context of this question?

Senator METZENBAUM. You are right on target.

Mr. ANDERSON. It is a troublesome area, perhaps, Mr. Chairman, because obviously, the trustees or those who have the authority under the terms of the plan to make investment decisions and ultimately to vote these proxies on behalf of and in the best interest of the participants and beneficiaries may be subject to what you might perceive, or some might perceive to be some pressure or some leverage.

It seems to me that it is appropriate for company management if it has a view, to express that view to the trustees and the independent fiduciaries. They after all may have some insight into what is in the best interest of the employees or the retirees of the company.

By contrast, I would also agree with you that it would be inappropriate if an independent fiduciary were to cease to be independent in rendering a judgment with respect to how to vote those shares.

Senator METZENBAUM. Thank you very much.

Mr. Stone, do you wish to comment—and you may want to ask Covington and Burling if they have an opinion as to the ethical propriety of a lawyer telling or a corporation advising the pension managers how to vote their stock vis-a-vis a question that has nothing at all to do with the security of the funds that are entrusted to them.

Mr. STONE. This is an exceedingly complex area. You have many major pension funds which have a large number of managers—10, 15, 20, 30, 40 different independent managers. All of those managers operate within their own guidelines. Some of them may be inhouse managers. The majority of them generally are independent outside asset managers. And very often you will have the same stock owned by the fund in the portfolios of different managers, and the managers will take different approaches on how to vote the proxies.

Senator METZENBAUM. Now do you want to answer my question? Now that you have made a prefatory statement, do you want to answer my question? I am talking about the ethical, legal, moral aspects of telling a pension manager how that stock should be voted. I do not care if there are 40 different managers. What about the moral and legal and ethical aspects of that? They are supposed to be trustees, handling those funds for the benefit of the employees. Now they are told to vote the stock in a certain way in order to protect management from a takeover.

I am just asking you whether you think that is legal and ethical and moral.

Mr. ANDERSON. I think the question of how they vote is to be determined in the best interest of plan participants. And I think that is the general situation, and most managers vote in that fashion.

There are particular situations which can arise, and the manager who has got the responsibility to vote should make the vote in the interest of the plan participants. Management may lobby just as other stockholders may lobby, for a vote on various other stockholder proposals.

Senator METZENBAUM. Mr. Vine, you ought to earn your keep since you came down here today.

Mr. VINE. Thank you, Senator, for providing this opportunity.

I think ERISA is very clear on this issue that the plan fiduciaries must discharge their interest solely in the interest of participants and beneficiaries. It certainly would be inappropriate for them to cast a vote on any issue, whether it is a takeover measure or any other issue, for any other purpose, including the purpose of entrenching a particular management.

At the same time, as Mr. Stone indicated, it is certainly appropriate for different people to have different views of whether a particular issue should be resolved one way or another, and they are free to express the views to the plan fiduciaries.

Senator METZENBAUM. But not to instruct them.

Mr. VINE. Not to instruct them. Where you have an independent fiduciary, it has to listen to the competing views, but in the last analysis, it must make up its own mind and take full responsibility for making the appropriate decision under ERISA's fiduciary standards.

Thank you, Senator.

Senator METZENBAUM. Thank you.

I do not know if Mr. Gulotta or Mr. Anderson wish to comment.

Mr. GULOTTA. Yes. I believe it would be inappropriate for a fiduciary to instruct a fiduciary to vote a certain way if the result is other than maximizing the value of the assets in the plan. The fiduciary must act solely in the interest of the plan participants in investing those assets and in voting the shares.

Senator METZENBAUM. Thank you, Mr. Gulotta. The Chair, as you know, agrees with you.

Mr. HENDRICKSON. I think we face, as I am sure everyone realizes, a very difficult ethical and question also of moral and fiber strength here. If there are certain situations where it might behoove management to instruct voting one way or the other, I think it comes down to the moral strength and fiber of the fiduciary who is responsible for the overall good of the people, and that many times is a very difficult situation.

Senator **Metzenbaum**. Thank you very much.

The Chair will include the entire article from Investment Age, "CEOs Lobby for Pension Votes in Favor Anti-Takeover Plans"—we will put the entire article into the record at this point.

[The article referred to and additional material supplied for the record follows:]

PENSIONS & INVESTMENT AGE
MARCH 9, 1987

CEOs lobbied for pension votes in favor of anti-takeover plans

By Marcia Parker and Joel Chernoff

The chief executives of Rockwell International Corp and GTE Corp have sent letters to their Fortune 500 counterparts asking them to lobby their pension executives and money managers to vote in favor of anti-takeover measures

The letters went out just before special meetings were scheduled at which the two companies' stockholders were being asked to vote on management-sponsored charter amendments designed to ward off raiders

The changes were approved by wide margins by GTE stockholders Dec 24 and by Rockwell shareholders Feb 11

As of Dec 31, institutions held slightly more than 50% of both companies' stock, according CDA Technologies Inc., Silver Spring, Md

Pensions & Investment Age obtained copies of the letters, along with a memorandum from well-known takeover lawyer Martin Lipton of Wachtell, Lipton, Rosen & Katz, New York, that he sent to clients in mid-February urging them to follow the lead of GTE's Theodore Brophy and Rockwell's Robert Anderson and "make their views known to their pension fund managers, banks, insurance companies and other institutions."

Citing creation of investor groups such as the Council of Institutional Investors and T. Boone Pickens Jr.'s United Shareholders of America, and sponsorship by major pension funds of proxy resolutions attacking "poison pill" provisions, Mr Lipton said "it has become clear that institutional investors are supporting corporate raiders for the purpose of continuing the junk-bond bust-up takeover frenzy."

In his memo, Mr. Lipton also took one step further a controversial proposal by New Bedford, Mass -

Continued on page 61

The plea by Rockwell's Robert Anderson, left, for corporate executives to lobby their pension funds was heeded by Goodyear's Robert E. Mercer.

CEOs lobbied . . .

Continued from page 1

based Berkshire Hathaway Inc. Chairman Warren Buffet to impose a 100% tax on profits on stock held by institutions or raiders for less than one year. The "suggestion would be more meaningful if the holding period were five years rather than one year," he wrote.

Mr. Lipton did not return phone calls from a reporter. Messrs. Brophy and Anderson also did not respond to inquiries.

The letters had a direct impact on at least one corporate pension fund. Robert E. Mercer, chairman and chief executive officer of Goodyear Tire & Rubber Co., Akron, Ohio, acknowledged receiving the letters and said he had instructed company pension officials and money managers to vote with management.

"I completely support the letters. I think it's very important for all of us to communicate our views," Mr. Mercer said.

At J.C. Penney Co., New York, William Howell, chairman and chief executive officer, said the letters prompted a far-reaching discussion among Penney executives on the relationship between corporate management and pension fund executives and other institutional investors. No conclusions have been reached, he said.

Several other chief executive officers supported the letter-writing campaign because they believe top corporate officials had not communicated their views adequately to institutional investors in the past. Most declined to comment on whether they had directed their pension funds on how to vote on the proposals.

Reaction to the letters from government agencies was reserved. Responses from pension fund executives, money managers and shareholder rights groups ranged from supportive to outraged, with some believing the letters are a veiled attempt to pressure institutional investors into voting management's way.

But every pension fund executive and money manager said he had experienced pressure at some point.

Dennis M. Kass, assistant secretary in charge of the Department of Labor's Pension and Welfare Benefits Administration, called the letters "troubling," but said they must be viewed cautiously.

"It's important to bear in mind that a corporate fiduciary is within his rights to communicate a point of view to an investment manager," said Mr. Kass, who added the department is looking into the letters. There is "a huge amount of gray area," he said.

Mr. Pickens, chairman of Mesa Petroleum Co., Amarillo, Texas, and president of United Shareholders of America, took a more critical approach. "They're getting pretty bold. Don't you think more and more of these CEOs are out to protect their empires? That's what this letter-writing campaign is all about."

Roland Machold, director of the $21 billion New Jersey Division of Investment, Trenton, and a co-chairman of the Council of Institutional Investors, said the letters indicate management's disregard for shareholders.

"Management just wants to be accountable to themselves," he said. "They forget who owns the company."

The division holds about 2 million shares of Rockwell International.

W. Gordon Binns Jr., vice president and chief investment funds officer for the $31 billion General Motors Corp. pension fund, New York, said, "There was no coercion by (GM Chairman) Roger Smith on me or my staff in respect to that matter." He declined to disclose how the pension fund cast its vote.

But Mr. Binns, who also is chairman of the Financial Executives Institute's Committee on Investment of Employee Benefit Assets, said the group of private pension fund officials had no formal position on the issue but that most of its members believe the proxy voting function should be delegated to their outside investment managers.

In his Dec. 12 letter soliciting support for GTE's proposals, Mr. Brophy expressed his concern "about the heightened unfriendly merger and acquisition activity, and related greenmail, and what I consider to be the increasingly unhealthy short-term speculative nature of the nation's financial markets."

"We both recognize the economic and social implications of what I believe to be an overemphasis on short-term financial performance.

"There is a good chance that your pension fund owns shares of GTE voting stock.

"Because of the short-term orientation of certain money managers, absent specific voting instructions from plan sponsors, such money managers will vote against certain proposals similar to those proposed by GTE's board. Consequently, some plan sponsors have instructed their money managers not to vote against such proposals without the sponsor's specific approval.

"If you have not taken this step — and you agree that the proposals will benefit GTE's shareholders in the long term — I would greatly appreciate your providing specific voting instructions to your money managers to vote for the proposals adopted by GTE's board."

Similarly, Rockwell's Mr. Anderson asked for support from other executives, but asked for "assistance in encouraging" money managers who held Rockwell stock to vote for the company's dual-class capitalization proposal, instead of the "instructions" to managers sought by Mr. Brophy.

Mary McCue, director of public affairs at the Securities and Exchange Commission, said the commissioners believe communication between companies and their shareholders is "appropriate."

Labor's Mr. Kass concurred, and emphasized the burden lies on the investment manager to exercise fiduciary responsibility.

Noting the Employee Retirement Income Security Act of 1974 requires plan fiduciaries to act for the "exclusive purpose" of serving plan participants and beneficiaries, he said, "The more fundamental question is what the investment manager does on the basis of communications from a plan sponsor."

If plan sponsors assert control over the proxy voting decision, they may "retain liability for acts of omission and commission on the part of the investment manager," Mr. Kass warned. That is precisely the type of responsibility corporations seek to avoid by hiring outside experts to run plan assets, he said.

He said a corporate executive is free to communicate a view that voting in favor of an anti-takeover device will enhance shareholders' value in the long run.

Even if the plan sponsor goes beyond persuasion and orders a manager to vote a certain way or risk losing the pension fund's business, there may not be a violation of the law.

That situation is "very disturbing but may not rise to the level of illegality," Mr. Kass said. "The question is, 'What does the investment manager do with it?' "

"The best protection for an investment manager is to have (written) policies" for handling proxy resolutions, Mr. Kass said.

Robert A.G. Monks, former head of the Labor Department's pension office and now president of Institutional Shareholder Services Inc., Washington, criticized the chairmen of GTE and Rockwell for writing to "other CEOs in their capacity as plan sponsors," saying company chairmen act as trustees.

Andrew C. Sigler, chairman and chief executive officer of Champion International Corp., Stamford, Conn., said he was aware of the letters and believes they represent, not "pressure," but an honest effort at communicating with institutional investors.

"It's merely an effort to ask them to please consider our views," he said.

"Corporations have abdicated their vote to 30-year-olds on Wall Street," he said. Now corporations "are bringing the vote back in-house."

But Richard M. Schlefer, investment officer for the College Retirement Equities Fund, which had almost 2.5 million shares of GTE and 1.3 million shares of Rockwell as of Dec. 31, expressed strong concerns about the letters.

"As holders of shares we would be very concerned about any pressure on a fiduciary to violate their responsibilities under ERISA," he said. "These letters represent unfair and inappropriate pressure. It's really asking managers of those funds to violate their responsibilities."

Several other pension fund executives were less worried.

"They've been doing it unofficially for years. Now they are just coming out into the open," said Greta Marshall, investment manager of the $38 billion California Public Employees' Retirement System, and former head of the Deere & Co. pension fund, Moline, Ill.

But noting the difference between managing corporate and public pension funds, Ms. Marshall said, "We haven't seen fit to go to our managers and ask them to vote our point of view. It's one thing for a corporate executive to ask managers to vote stock in their own pension plans a certain way. It's another to ask them to vote other people's shares that way."

Charles Miller, president, Criterion Group, Houston, said he sees nothing wrong with "active communication. That's very positive. Why should corporate chieftains be second-class citizens?"

George Cowles, senior vice president, Bankers Trust Co., New York, which holds stock in both GTE and Rockwell, said he doesn't view the letters as pressure. "The letter itself isn't pressure," he said. "It's the response that can generate pressure. It depends on how corporate America responds."

In Mr. Cowles' view, "the plan sponsor is the source of all authority, so if a sponsor wants to instruct his pension fund manager on how to vote proxies, that is his prerogative."

Mr. Cowles said the real question is whether the voting function should be delegated to the investment manager. He said executives are beginning to ask questions about the whole proxy voting process.

One option that could avoid pressuring of managers would be to require public disclosure of how institutional investors vote their shares, said James Heard, deputy director of the Investor Responsibility Research Center Inc., Washington. Other investment officials agreed, but Mr. Kass questioned what effect it would have.

Hicks B. Waldron, chairman of Avon Products Inc., New York, recently said Avon has taken charge of how the corporate pension fund managers vote on issues by establishing procedures for voting proxies.

"When I looked into our practices . . . I discovered that our managers were voting on the issues as they — not we — saw fit. But it is we who have the fiduciary responsibility. We can't, shouldn't and don't want to abdicate that responsibility," Mr. Waldron said in a speech in mid-February.

A pension fund manager for a major company with positions in both GTE and Rockwell said Mr. Brophy "went too far. His letter showed all the worst sides of the old-boy network."

Corporate executives and others also were divided on the proposal by Mr. Buffett to impose a 100% tax on profits on stock held by institutions or raiders for less than one year.

At a March 4 hearing on hostile takeovers before the Senate Committee on Banking Housing and Urban Affairs, 16 chief executive officers testified in strong support of the tax. They differed, however, on the length of the holding period, with several saying five years, as suggested by Mr. Lipton, was too long.

Some even went a step further, suggesting voting rights not be given to short-term stockholders.

But several pension executives and money managers said the proposal would drive capital away from the stock market.

Dave Williams, president of Alliance Capital Management Corp., New York, called the 100% tax "using the atomic bomb to kill a fly. The capital market would go into a deep freeze."

A five-year holding period would cause stocks to be viewed as bonds, said New Jersey's Mr. Machold. Stocks would have to offer yields of 14% to 16%, based on current bond yields, because they offer lower quality than junk bonds, he added. ■

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April 15, 1987

Honorable William Clay, Chairman
Subcommittee on Labor Management Relations
Committee on Education and Labor
United States House of Representatives
Washington, DC 20515

Re: Overfunded Defined Benefit Pension Plans

Dear Representative Clay:

The Pension Committee of the Institute of Electrical and Electronics Engineers, Inc. (IEEE) submits the following comments and recommendations for inclusion in the record of the recent joint oversight hearings on overfunding and underfunding of pension plans.

IEEE is the world's largest engineering society. It currently represents more than 280,000 electrical and electronics engineers, some 229,000 of whom live and work in the United States. Since the early 1970's IEEE has actively supported Federal legislative initiatives designed to improve the nation's voluntary pension system and worked to encourage the development of employer sponsored pension programs and savings plans that will provide a greater measure of economic security for working Americans during their retirement years. Among our current concerns are the potentially adverse effects of plan terminations on the retirement security of the millions of active and retired workers who are covered by defined benefit plans.

In our opinion, the continuing incidence of overfunded defined benefit plan terminations presents a potentially very serious threat to the long term stability of America's private pension system. Without appropriate changes in current law and regulations, businesses whose pension plans accumulate more than enough assets to meet current obligations to plan participants will continue to be encouraged to terminate such plans in order to recover excess or surplus assets and to use such assets for purposes unrelated to the provision of retirement benefits for employees.

The magnitude of future benefit losses to participants whose pension plans are terminated varies; depending on whether or not and what kind of successor or replacement plan is offered by the employer. Future benefit losses are likely to be greatest when terminated plans are not replaced by other plans. But benefit losses will also occur when terminated defined benefit plans are replaced by defined benefit plans without prior service credits or by less defined contribution plans.

In addition to their adverse effects on future benefits promised to active and retired workers whose plans are terminated, the cumulative effect of overfunded plan terminations is almost certain to reduce the solvency of the current system of termination insurance underwritten and administered by the Pension Benefit Guaranty Corporation (PBGC) and thereby compromise the long term benefit expectations of increasing numbers of active and retired plan participants.

In order to reduce existing incentives to termination of overfunded defined benefit plans, IEEE recommends that legislation be enacted and regulations promulgated that will limit the circumstances under which plan sponsors are permitted to terminate overfunded plans and explicitly authorize the withdrawal of excess assets from ongoing plans. Such legislation and regulations should include the following terms and conditions:

1) Calculation of plan liabilities on a termination basis using the PBGC interest rate for deferred annuities.

2) Authorization of access to and withdrawal of plan assets in excess of 140 percent of plan liabilities. This funding cushion is needed to provide for expected future salaries and increases in the cost of living.

3) Imposition of a 20 percent income tax surcharge on reversions resulting from plan terminations and a 10 percent surcharge on amounts that are withdrawn from ongoing plans.

4) Establishment of a waiting period between authorized withdrawals of at least 10 years following the withdrawal of excess assets from ongoing plans.

5) Treatment of withdrawals as experience losses to be amortized over a 10 year period.

6) A requirement that plan sponsors provide participants with advance notice of pending plan terminations and withdrawals along with a clear and understandable explanation of the effects of these actions on each participants retirement benefits.

In order to further protect PBGC administered programs of plan termination insurance for workers who participate in private sector defined benefit plans and provide additional incentives to employers to maintain adequately funded plans, IEEE also recommends that consideration be given to establishing a variable risk related premium based on each plan's funded status. Provisions for adjusting the rate to reflect changes in funding status resulting from reversions and withdrawals should also be considered.

IEEE's Pension Committee appreciates this opportunity to offer comments and recommendations on overfunded defined benefit plan terminations. We look forward to working with the Congress and other concerned organizations in an effort to find a practical solution to this complex and controversial problem.

Sincerely,

Jack S. Andresen, Chairman
Pension Committee
United States Activities Board
Institute of Electrical & Electronics
Engineers, Inc.

COMMENTS BY
AIR LINE PILOTS ASSOCIATION
TO THE
SENATE SUBCOMMITTEE ON LABOR
AND THE
HOUSE SUBCOMMITTEE ON LABOR MANAGEMENT RELATIONS
CONCERNING
THE ADMINISTRATION'S PROPOSAL FOR THE FUNDING
OF
DEFINED BENEFIT PENSION PLANS

MARCH 23, 1987

Introduction

The Air Line Pilots Association, International (ALPA) appreciates this opportunity to present this statement to the Senate Subcommittee on Labor and the House Subcommittee on Labor Management Relations. ALPA represents 39,000 pilots who fly for 48 airlines, for purposes of collective bargaining under the Railway Labor Act. As such, ALPA oversees literally hundreds of retirement and welfare benefit plans covering over 46,000 active workers, retirees and survivors.

The Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans

The Air Line Pilots Association (the Association) has long advocated pension reform to strengthen the security of workers' retirement funds. We concur with the Administration's statement that public policy should encourage optimal, rather than deficient or excessive, funding of pension obligations. Briefly stated, the Administration's proposal for assuring that the nation's private pension system will be optimally funded is to modify the existing law concerning the liability, funding and termination of defined benefit plans.

A. The Administration's Proposal Concerning Overfunded Defined Benefit Plans

Under the Administration's proposal, plan sponsors would be permitted to withdraw the assets of an overfunded plan without terminating the plan so long as the plan retained an asset "cushion" called the "minimum benefit security level." This asset cushion would be equal to the greater of (1) the termination liability of the plan plus 100 percent of the excess of the full funding liability of the plan (calculated under the projected unit credit funding method) over the termination liability of the plan or (2) 125 percent of the termination liability of the plan.

We agree with the Administration's recognition that the uncertainties of current economic conditions require an asset balance greater than a plan's termination liability to assure that a reversal of a business' prosperity does not threaten a retiree's security.

We are concerned, however, by what appears to be a logical inconsistency contained in the proposal. It appears that the ten percent excise penalty will be assessed upon the asset reversion regardless of whether the reversion is from a plan termination or a withdrawal. If this is a correct interpretation of the proposal, why would a plan sponsor ever choose to take a withdrawal rather than terminate the plan? The proposal appears to provide a positive incentive for an employer to terminate a plan rather than withdraw excess assets. We suggest that in the event a plan sponsor negotiates the termination of an excess funded defined benefit plan rather than withdraw the excess that the plan sponsor be limited to receiving an amount equal to the reversion less the minimum benefit security level. An amount equal to the minimum benefit security level should then be used to increase participants' benefits. This would preclude the plan sponsor from reaping a windfall for terminating the plan rather than withdrawing the excess from the plan. Alternatively, the assessment of a greater excise tax in the case of plan termination equal to the minimum benefit security level would provide a deterrent to plan termination.

The Air Line Pilots Association would like to recommend that an exception to the prohibition against the re-establishment of a defined benefit plan be made for collective bargaining plans of employers who, by termination of a defined benefit plan exit the defined benefit plan system entirely. Such a prohibition would interfere with the collective bargaining process and would encourage the termination of defined benefit plans as a strategy to save labor costs.

The Administration's proposal provides that the transfer of plan sponsorship beyond the control group would be treated as a plan termination for the purpose of determining the extent to which assets in excess of the plan's termination liability may be transferred with the plan beyond the control group. Prior to the transfer of sponsorship, excess assets that would not be available to the employer upon plan termination would have to be transferred to other defined benefit plans of the employer (or control group). The effect of this provision would be to discourage the termination of excess funded defined benefit plans to fund the cost of an acquisition during a corporate takeover . In so far as the provision discourages the termination of defined benefit plans, we support it; but, with the proviso that the proposal be modified so that the plan assets transferred beyond the sponsorship of the control group include an amount equal to the minimum benefit security level. To permit the transfer of funds equal to the termination liability without the additional minimum benefit security level would unjustly favor one group of employees over another.

In preparing these comments, the Association assumes that it is not the intent of the Administration that the collective bargaining process be curtailed in any fashion. We assume that the reversion of excess assets to the employer, whether by plan termination or withdrawal, will still be a negotiable item.

B. Funding

As Exhibit D of the Administration's proposal so clearly demonstrates, the current legal structure for assuring adequate funding for defined benefit plans is woefully inadequate. This will become even more apparent as we enter an era of lower interest rates.

We endorse each point of the Administration's proposal to rationalize the legislative schema to assure adequate plan funding. The establishment of a required funding ratio, the extension of plan liabilities (and attendant deductions) to all members of the control group, the requirement of quarterly contributions, the acceleration of the amortization period and the increased deduction limits are well conceived and carefully considered. Apropos the proposal's requirement that plan contributions be made on a quarterly basis, we are concerned that such a requirement, absent enforcement, is of little value. The Association recommends that in the event an employer does not make a quarterly contribution, the employer be required to notify plan participants and the participants' union of the lapse. In addition, the Association recommends that absent a waiver, failure to make a quarterly contribution be considered a violation of the minimum funding standard requirement and that the same penalty that is currently applied to violations of the minimum funding standard requirement apply to late or missed quarterly contributions.

Although it is arguable that the restructure of the minimum funding rules, the shorter amortization periods for waived contributions and the quarterly schedule for contributions will increase the plan sponsor's cost of maintaining defined benefit plans, this increased cost is offset by the increased permissible deduction and the dispersal of liability across the broader base of the control group. In addition, the proposal retains the relief afforded by minimum funding waivers. However, it has long been the position of the Air Line Pilots Association that the use of the procedure for obtaining a minimum funding waiver has been open to abuse. The Administration's proposal, which we heartily endorse, takes two steps towards curtailing the potential for abuse. The proposal provides for an increase in the interest rate required on waived contribution to the greater of the plan rate or the market rate for loans to distressed companies. This would preclude employers from using waivers as a source of a cheap loan.

Another area of potential funding abuse, which is not addressed by the Administration's proposal, is the flexibility granted actuaries in setting and applying the actuarial assumptions used to determine the necessary funding for a defined benefit plan. In several cases the Association has seen employers relieved of any obligation to make contributions by the single stroke of an actuary's pen. In these instances, plan participants were not made aware of the threat to their plan's security until more than a year after the fact. A serious possibility exists that these plans would be underfunded if terminated today. Therefore, while applauding the efforts of the Administration to strengthen the minimum funding standard, we believe that until actuarial assumptions and control of actuarial changes are regulated and prior notice to plan participants of actuarial changes is mandated, the proposal does not adequately protect plan security.

In addition, the proposal would extend the right to comment about applications for waivers, which unions now enjoy, to plan participants and beneficiaries. This right to comment, absent the right to review the application so as to be able to formulate intelligent objections to the waiver, is of dubious value.

C. Termination of Underfunded Plans

The Administration's proposal rightfully shifts the primary responsibility of seeing that promises concerning employee benefits are kept by the employer who made those promises. By requiring a plan to be funded to the full level of its termination liability prior to a standard termination, rather than its benefit commitment level, an employer cannot escape its obligation to provide all the benefits it promised to its employees. This is especially important in collective bargaining plans where the promise of benefits are often negotiated in exchange for current wages. If a plan is permitted to terminate under a standard termination if only funded to the benefit commitment level then current wages are given up in exchange for nothing.

The Association supports the limiting of the availability of a distress termination to situations in which the entire control group must meet the criteria for a distress termination. The Association, however, does not support the concept of permitting the transfer of excess funds from an overfunded plan to underfunded plans in a control group. As stated earlier, we believe that it is unjust to increase the security of the retirement plan of one employee group by jeopardizing the retirement plan security of another, especially in situations where one or more of the plans have been bargained for in exchange for wages and working conditions.

The Administration's proposal provides that, except to the extent permitted by the PBGC, an employer (control group) will be precluded from establishing a retirement program which provides substantially similar benefits within five years after the termination of a plan which did not have assets sufficient to provide PBGC guaranteed benefits. The Association recognizes the absurdity of permitting an employer or control group which terminates a plan that is so underfunded as not to be able to provide the PBGC minimums to immediately re-establish a similar retirement plan. However, the fortunes of a company, or structure of a control group, can change substantially in the course of five years. It is, therefore, our recommendation that upon application by the plan sponsor, the PBGC apply a facts and circumstances test before prohibiting the reestablishment of a plan.

Of course, the Association's qualified support of the Administration's proposal concerning the termination of an underfunded plan is contingent upon the assumption that there be no diminution of a union's ability to negotiate the disposition of a collective bargaining plan.

E. Retiree Health Funds

The Air Line Pilots Association is very cognizant of the need to provide adequate medical benefits for retirees and applauds the provision in the Administration's proposal which would permit employers to transfer defined benefit assets available for withdrawal to tax favored health funds for retirees without current tax consequences. Unfortunately, there is no incentive for an employer to effect the transfer. Although such a transfer would not be subject to the 10 percent excise tax on asset withdrawal or reversion, or to current income tax, the same tax deferral could be achieved by simply allowing the surplus funds to remain in the defined benefit plan. Furthermore, once the funds are transferred to a retiree plan the employer's choice of whether to tap the plan's excess funds for other business purposes is foreclosed. Without further incentive, very few employers would avail themselves of the opportunity to fund a retiree health fund in this manner.

Furthermore, the Association recommends that funds transferred from an overfunded defined benefit plan to a retiree health fund be available for all retirees, not just those who were retired on the date of the transfer. If, indeed, the excess funds of the defined benefit plan are attributable to benefits negotiated in exchange for wages, equity would require that those employees, both future retirees and current retirees, whose wages contributed to that excess fund reap the benefit of the availability of those funds for retiree medical benefits.

Following the same logic, the Association strongly believes that any retiree medical benefit plan funded with a transfer from a defined benefit plan should be limited to providing benefits for retirees who were participants in the plan or predecessor plan from which the funds were withdrawn. We also recommend that the transfer not be restricted to an amount not in excess of the present value of the employer's liability for health benefits for current retired employees, at least in the case of collectively bargained plans.

The proposal states that it would "permit employers to transfer defined benefit plan assets available for withdrawals to a tax-favored health fund for current retirees . . . ." (emphasis added). The Association concludes that from this statement that the use of assets from a collective bargaining plan for the establishment of a retiree health fund would be subject to the collective bargaining agreement.

CONCLUSION

The Air Line Pilots Association strongly supports the efforts of the Administration to articulate national retirement policy and to implement certain reforms in furtherance of that policy. Although we have specific concerns about the effect of certain of the Administration's proposals, we believe our concerns can be addressed without deviating from the established policy. We stand ready to provide whatever assistance may be required to promote these goals.

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March 13, 1987

Mr. David M. Walker
Deputy Assistant Secretary
Office of Pension and
Welfare Benefit Admin.
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Administration's Proposal on the Funding and
Termination of Defined Benefit Pension Plans

Dear Dave:

I appreciate the time you took last week to visit with John Erlenborn, Ed Burrows and me regarding the "Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans", and as promised I have summarized my reaction in this letter to you. Perhaps the best way to summarize my reaction would be to comment that every time we were asked the question "What don't you like about the proposal" we responded by asking the question "What should business like about the proposal?" Every time the question was reversed, the original questioner could think of little the business community might like about the proposal. This reaction sums up my reaction to the proposal. In my opinion the proposal (a) takes an "all or nothing" approach to defined benefit plans, (b) is one short step away from proposing the termination liability be a plan's full funding limit based on the projected unit credit cost method, (c) violates general restraint of trade principles, and (d) ignores the necessity of a variable rate PBGC premium and how such a premium would be combined with necessary changes in the minimum funding rules. In summary, I believe this proposal provides a blueprint for the destruction of the remaining defined benefit pension system in the United States.

Specifically, the proposal deals with five subject areas, namely,

1) Employer access to plan assets by way of withdrawals from ongoing defined benefit plans.

2) A strengthening of the minimum funding standards for defined benefit plans.

3) Plan investment in employer securities.

4) The termination of underfunded plans.

5) Retiree health benefits.

I would like to provide editorial comment on each of these proposed areas, and I invite your reaction and criticism of my remarks.

I. EMPLOYER ACCESS TO PLAN ASSETS

In the proposal's "Reasons For Change" section, it is indicated that "the plan remaining or re-established pursuant to the Guidelines does not have a cushion of assets above the level of the plan's termination liability. The absence of this cushion reduces participants' benefit security with respect to future benefit accruals and may also discourage employers from granting ad hoc benefit increases or cost of living allowances for retirees." Based on my tenure on the Asset Reversion Task Force, my understanding is that studies have shown on a termination/re-establishment, the re-established plan very quickly develops an asset cushion in excess of the plan's liabilities. Furthermore, if an employer terminating an overfunded plan had any intention of increasing benefits either on an ad hoc or COLA basis, the employer probably would not have terminated the plan. Thus, I believe it is specious to conclude the absence of the cushion may discourage the employer from granting future benefit increases when, in fact, the termination belies that intent. Given the assault over the last few years on the defined benefit system by a variety of Administrations, Congresses, Staffers, and Regulators, why would an employer dramatically want to increase his liabilities under a defined benefit plan? The proposal also indicates it is not "uncommon" for an employer to maintain an overfunded salaried plan and an underfunded hourly plan. While it may not be "uncommon", I do not believe this type of situation is that prevalent. I would be interested in seeing any backup statistics you have to support any of these three referenced claims (regarding benefit security, future benefit increases, and underfunded companion hourly plans).

With regard to an explanation of the proposal dealing with the employer's ability to access plan assets, I can summarize my remarks by saying I would be stunned if more than a handful of employers maintaining defined benefit plans would ever access assets via the proposed withdrawal mechanism. First, by making the withdrawal contingent on the funding status of the controlled group and tying and limiting withdrawals under the "frequency limit" rules, many employers will decide not to access the assets. More importantly, the definition of "minimum benefit security level" will preclude the vast majority of employers from being able to access excess assets on withdrawal, even if they chose to do so. Granted, this part of the proposal is ambiguously worded. However, from my reading of the "minimum benefit security level" definition, a plan must have hit the full funding limit before an employer could access excess assets. If this is the case, the 125% rule is virtually unnecessary, because not many defined benefit plans have hit the full funding limit. Furthermore, to allow a reduced cushion for annuitization of benefits leads one to the inevitable conclusion that the Department of Labor will then have to get into the business of grading insurance companies. For example, who is to say a portfolio of Triple A bonds would not provide more adequate security than having benefits annuitized by an insurance company whose investments are primarily in junk bonds. Finally, you indicated to me since FASB requires the use of the projected unit credit funding method for purposes of FASB 87, that this cost method provides an appropriate benchmark for purposes of calculating a plan's liability for purposes of asset withdrawals. Your jump from FASB to this definition for minimum benefit security level is a bit of accounting alchemy which is unable to be understood by me. How one can jump from a controversial FASB rule for corporate balance sheet purposes to an actual liability number for purposes of accessing excess assets is beyond me. Furthermore, it is one short step from this definition of minimum benefit security level to what I am sure either has been or will be proposed be the actual termination liability for a plan, namely, that such termination liability be calculated using the projected unit credit cost method as the basis for calculating the termination liability.

As referenced earlier, the proposal's provisions dealing with asset reversions on plan termination, sponsorship and asset transfers, frequency limit rules, and the imposition of a 10% excise tax not only on termination reversions but also withdrawals will lead existing defined benefit plan sponsors to approach their defined benefit plans on an all or nothing basis, poses substantial restraint of trade issues, and will certainly inhibit any sponsor considering a defined benefit plan from implementing one. As a consulting actuary, I will have to advise my clients rarely to consider increasing benefits under their plans and, if they do not maintain defined benefit plans, not to consider implementing one. The rules dealing with asset reversions on plan termination and the frequency limit highlight this concern. Specifically, the proposed rules indicate if a company sponsors one or a multitude of defined benefit plans, with such plans having been in effect for at least 10 years, then an employer cannot withdraw or terminate/revert on more than three occasions during any 10-year period, and in order to withdraw, all corporate sponsored plans' assets--including single employer collectively bargained plans--must in combination exceed the minimum benefit security level for reversion purposes (which will be virtually impossible) and virtually all plans will have to be terminated in order for any reversion assets to be distributed to the plan sponsor.

Finally, with regard to collectively bargained plans, the proposal indicates "in the case of determining whether an employer has exited the defined benefit system...such rules...would...apply to multiemployer plans." Thus, the proposal indicates if an employer maintains one or more overfunded defined benefit plans but contributes to one underfunded multiemployer plan for even one employee, such employer is precluded from exiting the defined benefit system.

II. MINIMUM FUNDING STANDARDS

On balance, I completely support stronger minimum funding standards, and as many of us have said since ERISA was passed, the establishment of tighter funding standards at that time would have precluded many of the negatives relative to funding and PBGC liability which have transpired since then. My comments regarding the proposal dealing with minimum funding standards are quite technical in nature, dealing as they do with actuarial principles and concepts. Therefore, perhaps it would be more advisable to have the appropriate actuaries involved in the process meet with you and Harry to discuss these matters. Basically, however, as we discussed in our meeting, I believe different rules which pay closer attention to the average working life expectancy of the group, should apply to amortization of liabilities for benefit increases and I believe waivers should be completely disallowed.

III. PLAN INVESTMENT IN EMPLOYER SECURITIES

The proposal indicates "many employers have issued stock to their employee benefit plans that has features that are substantially different from stock issued by the employer to other investors." To the extent employers are issuing stock with no readily ascertainable market value, or without appropriate safeguards, I agree limiting factors should be associated with such transactions. Additionally, in the area of "floor-offset" arrangements supported by employer stock, I agree wholeheartedly that some limitations should be imposed on these transactions. On balance, I support the proposal, because I believe few, if any, employee interests are enhanced by transactions such as this. This is the reason ESOPs exist, and I do not believe ESOPs and defined benefit plans should be combined in a floor-offset approach.

IV. TERMINATION OF UNDERFUNDED PLANS

All of us are aware of the incredible problems facing the PBGC, both currently and prospectively. To a great extent, SEPPA assisted the PBGC in being able to make good on its claim for employer assets. Aside from some difficulties contained in SEPPA, such as the 75% limitation on the PBGC's claim regarding unfunded PBGC guaranteed benefits, as well as the exclusion of a variable rate premium structure, SEPPA should work quite well in the future. I believe modifications to SEPPA could be proposed in lieu of the proposal's provisions dealing with underfunded plans.

Specifically, the Proposal would make an employer's termination liability to participants equal to the plan's termination liability to participants. The proposal further indicates "this is consistent with the FASB rules requiring an employer to account for plan liabilities". Again, it is a big jump from a controversial FASB decision to government edict, and I can see no logical, reasonable or justifiable basis for making that jump. Additionally, under the subsection entitled "Employer's Termination Liability", the proposal indicates "the required plan asset level for a standard termination would be increased from the current law requirement of 'benefit commitments' to the full level of the plan's termination liability to participants. For this purpose, the plan's termination liability would include all fixed and **contingent** accrued benefits that would be provided if the plan had sufficient assets." (emphasis added) A careful reading of this subsection leads me to the conclusion that the Administration would support a proposal defining "contingent accrued benefits" as accrued benefits developed on a prospective salary-adjusted basis. In other words, as I referenced with regard to my comments on using the projected unit credit cost method for purposes of accessing excess assets, it appears you might support the argument that the overfunding in salary-related defined benefit plans is a function of deferred wages and that such deferred wages should be made payable to plan participants in the form of excess assets in the event of plan termination. I would appreciate specific delineation of intent relative to this provision.

V. RETIREE HEALTH BENEFITS

In summary, the retiree health benefit provisions would eliminate options available under IRC 401(h) in trade for the ability of plan sponsors to transfer excess assets from an ongoing plan (subject to the minimum benefit security level rules) to an IRC 419 trust. Additionally, such transfer would be counted as a withdrawal for purposes of the frequency limit on withdrawals and reversions. The problem with the proposal is that it takes away more than it provides. First, only a handful of companies could access this provision because of the limiting rules on withdrawals. Second, this section of the proposal suggests that present value calculation of retiree health benefits will have to be made in order to avoid "inappropriate" overfunding of the retiree health fund. Since every section of the country has different health care costs, "appropriate" funding rules might be different for Mobile, Alabama and Cleveland, Ohio. Additionally, health care costs are probably going to be much higher in cities like Cleveland, which will also be the cities where industries will typically be experiencing the retiree health problem in greater magnitude than in other cities. Thus, the proposal's provisions on retiree health do little to ameliorate the problem and, in fact, provide less than current law.

MISCELLANEOUS

The Proposal leaves open a multitude of unanswered questions, and specifically the proposal indicates 13 areas requiring clarification, such as the development of:

1) Appropriate assumptions and methods for valuing a plan's termination liability and plan assets for purposes of asset withdrawals;

2) Appropriate allocation rules for distribution of excess assets from a controlled group member terminated plan, assuming all plans of the controlled group are not terminated;

3) Special rules to deal with changes within the controlled group (*i.e.*, regarding acquisitions and dispositions of divisions or subsidiaries maintaining defined benefit plans);

4) Appropriate allocation rules to transfer excess assets from an overfunded controlled group plan to another controlled group defined benefit plan prior to any transfer of plan sponsorship to an unrelated company;

5) Special frequency rules to deal with the sale and purchase of divisions and subsidiaries with defined benefit plans and with changes in the structure of the controlled group;

6) Detailed rules on the impact of multiemployer plans being maintained by employers;

7) Rules for underfunding relating to certain types of contingent benefits, such as shutdown benefits;

8) Special rules to modify the treatment of certain underfunded plans where contribution requirements under the new minimum funding rules would exceed "reasonable" limits;

9) Special rules limiting minimum required contributions under the "cash flow" rule in the case of frozen or retiree-only plans;

10) Special rules providing additional restrictions on funding waivers;

11) Appropriate rules to prevent against the use of new minimum funding rules to gain inappropriate deductions;

12) Special rules regarding transfers of assets between underfunded and overfunded defined benefit plans where there are different benefit levels among plans; and

13) Appropriate rules to calculate the present value of retiree health benefits.

Finally, one of the more perplexing provisions of the proposal deals with effective dates and transition rules. The Administration is proposing the effective date for the new rules to be December 31, 1987, with the caveat that the Administration might like to have the option to retroactively implement every other rule in the proposal.

In summary, I believe this proposal, on balance, is bad for business, bad for plan participants, and bad for the private voluntary pension system. While I totally support stronger rules on funding, as well as a variable rate premium structure (which was conspicuously absent from the proposal, where it should have been tied to the rules on minimum funding, as well as rules relating to the minimum benefit security level), the other limitations associated with the proposal, particularly in many areas regarding controlled groups and general restraint of trade principles, makes the proposal unworkable. If enacted, the proposal will at a minimum preclude any employer from establishing a new defined benefit plan of any size, as well as mitigate against any substantial benefit enhancements by plan sponsors maintaining defined benefit plans. This proposal will, like many that preceded it, further limit participant benefit security by compelling employers to leave the defined benefit system or not to enter it at all. When this happens, the cry for a mandatory pension system will grow loudly, and our current voluntary system will be placed in further jeopardy as a result of this proposal having been made.

Dave, substantial portions of this proposal deal with an issue which time may have resolved, namely, the issue of large reversions from overfunded plans. For example, in 1986, of the total reversion dollars to 120 plan sponsors, approximately 50% was attributable to two large plan terminations, namely, Exxon and Phillips. Thus, rather than supplanting the Guidelines with this Proposal, I suggest the Administration support legislative initiatives dealing with the underfunding issue and new minimum funding rules, and that such initiatives be combined with the Administration's proposal for a variable-rate PBGC premium.

I realize my comments are unwelcome by the people who fashioned this proposal at the Administration level, as well as by those in Congress who will seek to embrace it as a "starting point" for further change. After you have had a chance to review and consider the points raised in my letter, I would appreciate the opportunity to visit with you again. If you would like to do so, please let me know and we can arrange a mutually convenient time to meet and discuss the points raised in this letter.

Very truly yours,

Jerry

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American Council of Life Insurance

STATEMENT OF
THE AMERICAN COUNCIL OF LIFE INSURANCE

on
The "Administration's Proposal on Funding and Termination of Defined Benefit Pension Plans"

Before the Subcommittee on Labor of the
Committee on Labor and Human Resources
of the United States Senate

AND

the Subcommittee on Labor-Management
Relations of the Committee on Education and
Labor of the United States House of Representatives

April 10, 1987

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This statement on the "Administration's Proposal on Funding and Termination of Defined Benefit Pension Plans" ("Administration Proposals") is submitted on behalf of the American Council of Life Insurance. The Council is the major trade association for the life insurance business, representing 635 life insurance companies. Together, these companies hold approximately 95% of the assets of all United States life insurance companies and 96% of the reserves for insured pension plans.

SUMMARY

Our nation will face a significant retirement income challenge in the future. By 2030, those 65 and older will constitute 20% of the population up from 12% today. Providing retirement income and medical care to this population will severely test Social Security and Medicare. Critical to meeting this challenge will be the extent and adequacy of private pensions and retiree health insurance. Consequently, national retirement policy must encourage employer sponsorship of adequate retiree pension income and health coverage. The life insurance industry shares the concern of this Administration, the Congress and others over the problems that threaten our nation's private defined benefit pension and retiree health plans. We are, therefore, pleased to have this opportunity to submit comments on the Administration Proposals in this area.

In fashioning its Proposals, the Administration has attempted to address the issue of maintaining the integrity of the defined benefit system which depends upon the proper funding of defined benefit pension plans. Within this context, fall two specific problems that are addressed in the Administration Proposals. First is the termination of overfunded pension plans so that employer sponsors can gain access to excess assets. Second is the termination of underfunded pension plans and the threat such terminations pose to the government's pension guarantee program. The Proposals also address the underfunding of retiree health insurance plans. Our statement addresses only the excess assets and retiree health benefit issues.

The Council believes that the requirement in current law that annuities be purchased when excess assets are withdrawn from a plan is the best way to protect the accrued benefits of plan participants. However, the current law requirement that a plan terminate before an employer can access excess assets causes unnecessary disruptions and additional costs. Thus, we can understand the desire to permit withdrawals of excess assets from overfunded defined benefit pension plans without requiring the plan to terminate. But, ongoing plan withdrawals should not leave plan participants with less benefit security than they now enjoy under current law. Although the 10% cushion with annuitization under the Administration Proposals accomplishes this objective, we are unconvinced that the proposed 25% cushion without annuitization does so.

As regards the Administration Proposals on the funding of retiree health benefits, the Council has supported and continues to support the adequate funding of post-retirement health care. While the Administration Proposals in this area would offer some relief from the overly restrictive provisions of current law, they do not, in our view, go far enough to alleviate the serious underfunding of retiree health benefits.

EMPLOYER ACCESS TO PLAN ASSETS

General Comments. It is important to recognize that without private pensions, adequate retirement income for most workers is unlikely. Fortunately, through responsible action by employers and the support of government-provided tax incentives, private pensions have flourished and will deliver financial security to a majority of employees in this country. Key to the continued success of this voluntary private pension system is the recognition, in the Administration Proposals, "that employers should remain able to make their own pension promises, provided that they are fully responsible for whatever pension promises they make." (Statement of J. Roger Mentz, Treasury Assistant Secretary (Tax Policy) before the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, March 6, 1987, (p. 2).) Similarly, in a voluntary pension system an employer should be permitted access to the excess funds in a defined benefit plan that are attributable to employer contributions, so long as the benefit promises made by the employer are fulfilled and the benefits to participants and beneficiaries are adequately protected. As to what constitutes "adequate" benefit protection, however, there are clearly many different ways of answering this question.

Aside from the more technical question of whether a particular required asset level of protection is mathematically sound, there is the broader question of whether benefit adequacy is to be measured in terms of accrued benefits, or is to include as well some element relating to future benefit accruals. Looking at these two criteria, it is fair to state that the current law rules regarding employer access to excess assets do an excellent job of protecting accrued benefits, but fall short in addressing benefit security with respect to future benefit accruals -- particularly in "termination/reestablishment" or "spinoff/termination" situations.

Under current law, access to excess funds is permitted only after an employer: 1) Terminates a defined benefit pension plan; 2) Fully vests all participants' benefits; and 3) Purchases and distributes annuity contracts to those participants. The current law requirement of annuity purchase provides participants with the assurance that all their accrued benefits will be paid in full. The value of the annuity to participants is threefold: 1) An annuity issued by a life insurance company provides participants with a guaranteed stream of retirement income; 2) Once an annuity has been purchased, the risk of making good on the promised benefit is transferred irrevocably from the employer to the life insurance company; and 3) All of the assets in the life insurer's general account support the guarantees in the annuity contracts that it issues as required by state law. Combined, these features provide a level of protection to plan participants that exceeds any other alternative.

Despite the fact that current law permits employers to gain access to excess assets while fully protecting the accrued benefits of plan participants, there are certain detriments associated with the present law requirement that a plan terminate before any excess funds become available to the employer. First, there are disruptions and costs associated with the termination itself. These include additional actuarial and administrative costs, as well as the intangible "cost" of lowered employee morale. More importantly, once an existing plan has been terminated, benefit security with respect to future benefit accruals or benefit increases under any new plan is reduced since (1) the purchased annuities do not extend to benefits earned after the termination; and (2) the termination -- by removing all excess assets -- usually eliminates any asset cushion that might otherwise have been used to fund these future benefits. As stated in the Administration Proposals, "an ongoing defined benefit plan with assets in excess of termination liabilities contains an 'asset cushion' that protects the plan against adverse investment performance in the future and may be used to fund future benefit accruals and increases .... Following a termination/ reestablishment or a spin-off/termination transaction, the remaining defined benefit plan generally has no such asset cushion." (The Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans, p. 3; emphasis added.)

This factor -- the loss of an asset cushion for future benefits -- seems to have strongly influenced the approach taken in the Administration Proposals to securing benefit "adequacy" in the excess asset reversion context. To address this perceived problem, the Administration Proposals permit an employer to withdraw funds from a plan -- without the need to terminate that plan -- provided a requisite "minimum benefit security level" (as defined in the Proposals) is maintained.

We agree that benefit security with respect to future accruals and possible benefit increases under defined benefit plans is a desirable goal and should be encouraged. However, any proposal aimed at protecting benefit adequacy, while allowing employer access to excess defined benefit plan funds, must focus first and foremost on the adequacy of funds to meet the promises the employer has already made -- that is, the benefits accrued up to that point in time. We have serious concerns that, to the extent the Administration Proposals move away from providing benefit security for accrued benefits by allowing employers to gain access to excess assets without requiring the purchase of annuities, significant additional risks for plan participants and their beneficiaries may be created. As discussed in greater detail below, not only may the Administration Proposals not accomplish the intended goal of assuring future benefit accruals, but the Proposals may not even adequately protect benefits accrued up to the time of the asset withdrawal.

B. Detailed Comments

Under the Administration Proposals, an employer would be permitted to withdraw assets from an ongoing defined benefit plan to the extent that after the withdrawal both: 1) the value of the assets remaining in the plan from which the withdrawal is made exceeds the "minimum benefit security level" for that plan; and 2) the value of the assets in all other plans maintained by the employer and the controlled group of which the employer is a part exceeds the "minimum benefit security level" for all such plans. The "minimum benefit security level" is defined as the greater of (1) the termination liability of the plan plus 100% of the excess of the full funding liability of the plan over the termination liability of the plan, or (2) 125% of the plan's termination liability. In cases where the termination liability has been annuitized, the "minimum benefit security level" required would be the greater of 40% of the excess of the full funding limit over the termination liability of the plan, or 110% of the plan's termination liability. Since the definition of the terms "annuitization", "termination liability" and "minimum benefit security level" are key to the question of benefit adequacy, we have several comments to make with regard to each of these items.

First, with regard to the definition of "annuitization", we assume that this term is to be defined as under current law -- i.e., the irrevocable purchase of guaranteed benefits from a licensed insurer. As previously mentioned, when annuity contracts are purchased, the investment, mortality and other demographic risks, such as the incidence of early retirement, are completely and irrevocably shifted with respect to the participant from the plan to the insurance company issuing the contract, and the annuity benefits are backed by all the assets in the insurance company's general account. By contrast, for example, the purchase of a dedicated bond portfolio where the cash flow is "matched" to the expected benefit payments does not completely eliminate the investment risk, i.e., the risk of early redemption and market value adjustment. Moreover, the full mortality and other demographic risks are still present. In addition, while the insurance company's promise under the annuity is irrevocable, the dedicated bond portfolio can be replaced by less secure investment alternatives.

Second, the way in which "termination liability" is determined bears directly on the adequacy of any cushion. We believe the components of termination liability should remain unchanged from current law. However, there must be a uniform methodology by which termination liability is established. We assume that the Proposals contemplate the use of the PBGC rates in computing termination liability. The use of the PBGC interest rate structure, mortality factors and early retirement assumptions may be an appropriate starting point in computing the amount of termination liability because they may produce a reasonable aggregate value of deferred and immediate retirement benefits. However, because the individual assumptions currently used by the PBGC for mortality and interest may not accurately reflect the expected experience of any individual plan, the additional 15% cushion in the Administration Proposals when annuities are not purchased is, in our view, insufficient to guarantee that the accrued benefits at the time of the asset withdrawal will be paid. Even if the PBGC made use of carefully selected termination liability assumptions, no cushion alone can protect against unanticipated events such as plant closings or unexpected levels of early retirement.

First, the mortality assumption generally required by state insurance regulations produces significantly higher liability amounts than the mortality table prescribed by PBGC. Furthermore, most insurers project for future improvements in their assumed rates of mortality when determining the expected cost of making promised annuity payments. Second, unlike the PBGC interest rates which use a scale inversely related to the normal duration slope of the yield curve, the interest rate generally required by state regulations is determined by the match of annuity liability with investments of similar duration. The greater the match the higher the allowable rate. Whenever a mismatch occurs, a lower interest rate must be used to reinforce the liability guarantee. Finally, with regard to subsidized early retirement benefits, the cost of such benefits is dependent on the average age at early retirement as well as the degree of subsidy provided by the plan. Early retirements are hard to predict and can fluctuate widely from year to year and from plan to plan. If the average early retirement age is overstated by one year, the liability can be understated 3% to 8% or more based on current interest rates.

Finally, we believe that the "minimum benefit security level" for participants is not adequately treated in the Administration Proposals. The purpose and measurement of the cushion included in the minimum benefit security level should be carefully defined. For example, in relation to vested accrued benefits, how much of the cushion is designed to guarantee the performance of the plan's assets? How much of the cushion is to provide for non-vested accrued benefits (which may not be valued as conservatively as vested accrued benefits)? How much of the cushion is to provide for future benefit increases based on service to date? The adequacy of each portion should be measured separately.

The cushion should not be determined merely by an average relationship of assets and liabilities over a long period of time (which seems to be the basis for the Administration Proposals) but rather by the range over which a single plan's asset/liability ratio might move over a short period of time. Any judgment about the amount of the cushion cannot be made without reference to a plan's investment policy, or more specifically its asset mix. Using a simplified example, it can be shown that the typical plan termination liability will increase (decrease) by 10% - 15% for each 1 percentage point decrease (increase) in interest rates. If all of the plan's assets were invested in a STIF (Short Term Investment Fund) whose value remains essentially unchanged as interest rates change, then a 2 percentage point decrease in interest rates dramatically increases a plan's termination liability and reduces the 25% cushion to a negative number.

We recognize that the concepts contained in the Administration Proposals are very complex and have not been fully developed. We are prepared to work with the Subcommittees in dealing with the concerns expressed in our statement.

RETIREE HEALTH BENEFITS

The Council welcomes the Administration Proposals as a first step towards dealing with the retiree health benefits issue. The Proposals would permit an employer to transfer excess plan assets which are otherwise available for withdrawal from a defined benefit plan to a retiree medical benefit fund. The amounts transferred would be exempt from the 10% excise tax and current income tax. (We assume that the transfer fund proposal would include a transfer either to a trust or to a reserve for retiree medical benefits maintained directly with an insurance company, both of which constitute a "fund" for purposes of Sections 419 and 419A of the

Internal Revenue Code.) The Proposals recognize one of the major issues currently confronting the employee benefits community. The escalating costs of post-employment benefits, especially retiree health care, in combination with severe restraints on advance funding for these liabilities, has forced the Financial Accounting Standards Board to step up its efforts to identify the appropriate accounting treatment for these retiree benefits.

The Council has supported and continues to support Federal encouragement of employers to adequately fund post-retirement health benefits. Unfortunately, the limitations of current law severely restrict the opportunity to advance fund these promised benefits. Although the Administration Proposals offer some improvement, the limitation and restrictions contained therein substantially offset their beneficial aspects.

Under the Proposals, the transferred assets could only be used to provide medical benefits to employees who had actually retired at the time of the transfer, and the amount that could be transferred would be further limited by the present value of the liability for such current retired employees. Thus, under the Proposals as now constituted, a preferred class of retirees would be created, based on the happenstance of when the transfer of assets occurred. We urge that this inequity be corrected and that transfers of up to the full present value of the liability for post-retirement medical benefits for both retired and active employees at the time of the transfer be permitted.

Moreover, under the Proposals, an employer who had determined not to fund retiree medical benefits and then later elected to transfer the excess pension assets to the medical "fund" would be able to obtain the same funding result as an employer who had set aside income each year in order to responsibly fund its retiree medical benefits under the more onerous rules of Sections 419 and 419A of the Internal Revenue Code. Thus, the Proposals encourage employers to gamble that excess pension assets will become available to fund retiree health benefits. If Congress believes that employers should be encouraged to pre-fund post-retirement medical benefits, then one approach should not be tax-preferred over the other as would be the case under the Administration Proposals.

The Proposals would also eliminate Internal Revenue Code Section 401(h) retiree medical benefit funds. As a result of the provisions in DEFRA which subject the income of retiree medical benefit funds to unrelated business income tax, Section 401(h) currently is the only vehicle available to employers wishing to pre-fund post-retirement medical benefits for their employees without having to pay tax on the earnings of the fund. Section 401(h) has not been a very attractive vehicle for funding such benefits, however, because of an arbitrary limit imposed by regulation on the amount of employer contributions. The effect of the regulation is to preclude an employer who has a well-funded pension plan from adequately funding the 401(h) retiree medical fund.

Despite its limited use, we oppose the repeal of Section 401(h) and urge that, instead, the current limit in the IRS regulations be liberalized. In addition, we believe that Sections 419 and 419A should be amended to eliminate the taxation of the investment income on post-retirement medical benefit funds. These Sections permit level funding of post-retirement medical benefits over the working lives of the covered employees. With these two changes, we believe employers will have two suitable options for funding the post-retirement medical benefits of their retirees.

The Administration's testimony given at the March 6, 1987 hearing of the House Ways and Means Subcommittee on Oversight gives two basic reasons why the tax-favored treatment of retiree medical benefit funds that was taken away in DEFRA should not be restored. One reason given is the potential revenue loss.

We agree that the budget deficit problem is one of great concern. However, we believe that lack of adequate funding of post-retirement medical benefits will only add to the Federal Government's financial burdens, as retirees will fall back on governmental programs if employer-provided medical benefits are not delivered to retirees as anticipated. The security of retirees' post-retirement medical benefits is such an important social, financial, and economic goal that revenue considerations, while important, should not alone control the policy decisions.

The second reason given for denying favorable tax treatment to the funding of post-retirement medical benefits is that tax-favored funding should be permitted only in such a way that the public costs are matched by the public benefits, such as by application of minimum standards similar to those applying to qualified pension plans.

The Council agrees that the question of what minimum standards should apply to retiree medical benefits funds is one that deserves careful study and consideration. The Treasury Department study mandated by the Deficit Reduction Act of 1984 is still unfinished, and once the Treasury study is released the issues raised will be subject to carefully Congressional scrutiny, public comment and debate. We do not believe that restoration of tax-favored treatment of retiree medical benefits should await the development of new minimum standards. The legislative safeguards that were enacted in 1984 already provide assurance that such funds will be used for their intended purpose. Again, we feel that the security of retiree medical benefit coverage is too important a social and economic issue to postpone the needed encouragement to employer funding while minimum standards are considered and debated.

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We appreciate the opportunity to present the views of the Council on the important issues raised by the Administration Proposals regarding the withdrawal of excess assets from defined benefit pension plans and the funding of retiree health benefits. We would be happy to respond to any questions you may have or provide any additional material you might find helpful.

Senator **Metzenbaum**. The record will remain open for an additional ten days. I want to say to this panel as I did the previous panel, we do not start off in total agreement. We all recognize, I think, that there is some action that needs to be taken, and we look forward to working with you. Our doors will be open to you, with the administration, as well as with the labor groups.

Thank you very much. The hearing stands adjourned.

[Whereupon, at 12:10 p.m., the Joint Hearing was adjourned.]

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